

The Economist

SHOWDOWN IN PUNJAB

page 21

AS MARXISM CRUMBLES

pages 12 and 47-49

NEXT, DEARER MONEY

page 77

QUESTION OF FAITH

after page 52

A survey of the Philippines

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Wunderkind at 40



PHILIPPINES
SURVEY
INSIDE

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Whether you're buying, selling or
merging, there are 'windows of opportuni

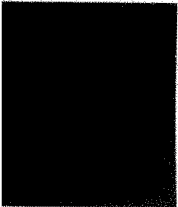
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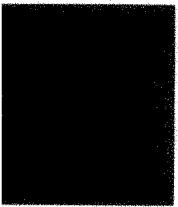
And even with a good prospect, the right opportunity can be a fleeting one.



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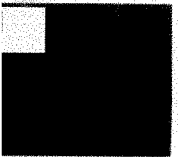
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Wunderkind at 40

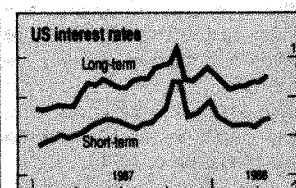
In 1948 West Germany freed its economy and wrought a miracle. Now it is complacent with its riches, weak in its foreign policy, page 11. And its biggest firms may be getting too big, page 61.

Punjab showdown

The world's worst terrorism, page 21.

Crumbling Marx

Communists strain at their one-party straitjacket, page 12, in Poland, page 47, Russia, page 48, and Hungary, page 59.



Next, dearer money

Interest rates edge up in America, Japan and West Germany, page 77.



Question of faith

For Aquino's Philippines. A survey after page 52.

Breathe free

A proposal to give refugees asylum, page 16. America ends a pretty successful amnesty for illegal immigrants, page 30.

House of Morgan

Tries to become investment bank, learns about pitfalls, pages 81-84.

Who's knocking?

Israel, at Syria's door, page 41.

LETTERS

Britain's new bourgeoisie

SIR—Your leader on the re-emergence of the British bourgeoisie (April 9th) praises the new tax treatment of capital gains as income because it will redress the balance between managers and shareholders. You go on to warn the bourgeoisie to avoid conspicuous consumption and, quoting Keynes, ask it to save as the bees do. However, these tax proposals will have the opposite effect on many.

The seed-bed of large companies and the bourgeoisie alike is the private company in which management and shareholders are indivisible. The retention of earnings used to be encouraged by high taxation of pay and dividends. Now pay and dividends suffer tax at a maximum of 40%. Retained earnings suffer corporation tax at 35%, and the balance carries the dead hand of deferred taxation at 40%—a total of 61%.

The formation of companies is less attractive, so is the flotation of existing ones. Do not be a bee but spend, spend, spend.

Thame,
Oxfordshire

DAVID GOMME

SIR—Your stirring leader "Growing rich again" was marred by the fanciful statement "The south-east of England is already one of the most classless places in Europe." It is the very invisibility of the new underclass, concentrated in the inner cities, which makes it all the

more important to keep it in mind. These are the people who will become increasingly absent from our view as some of them fail to register for the community charge, thereby forfeiting their rights to benefits and of course their places on any accurate statistic.

London SEBASTIAN KRAEMER

Danube dreams

SIR—Dreaming of what "the party line-up in a free Hungary" (April 2nd) would be is amusing, but about as fruitful as compiling a Politburo for Britain (Tony Benn? Vanessa Redgrave?).

Encouraging though it is that establishment figures like Imre Pozsgay are meeting writers, philosophers and environmentalists, the threat, as usual, comes from the other side. Workers and grassroots party members who see their living standards eroded and their jobs at risk tend to look back fondly to the days of good, old-fashioned socialism—and none too kindly on the aspirations of the intelligentsia.

A backlash against reform and economic common sense occurred once before, from 1972 to 1977, at enormous economic and political cost. Spare a thought for a party determined that this should not happen again, and also determined to broaden the frames of democracy and civil rights in Hungary.

Budapest

BRIAN MCLEAN

Reluctant Englishmen

SIR—In your leader on golf (April 16th) you call Sandy Lyle "a Scot who plays out of England". In fact, he was born in England, brought up in England and learnt his golf in England. His only connection with Scotland is his parents. Substitute Wales for Scotland, and this is true for Ian Woosnam too.

These are examples of a common phenomenon—the presence of English people who have an ancestor from the Celtic fringes that they are of that Celtic nationality. Why is this?



Perhaps they are showing a characteristic English desire to differentiate themselves subtly from their peers. Has anyone an alternative explanation?

Loughton,
Essex

J. DUFFIELD

Deposit insurance

SIR—The \$10.8 billion recapitalisation of the Federal Savings and Loan Insurance Corporation (authorised last summer by the Competitive Equality Banking Act) involves no taxpayer funds at all. Your remark in "Caveat depositor" (March 26th) that the FSLIC has had to "beg billions from the taxpayer" reflects some sloppy research. It is insulting to the 3,000-or-so private companies which would shoulder all of the repayment for those funds. These are being raised wholly in the private capital markets.

Chicago, Illinois
WILLIAM O'CONNELL
United States League
of Savings Institutions

Fusion's image

SIR—There has been at least one significant spin-off from fusion research, which you recently reviewed in admirable fashion. The technology used in mag-

netic resonance imaging (MRI) was developed by the fusion programme. The market for MRI magnets is about \$250m a year. The technology base of Oxford Magnet Technology in Britain was developed at the Culham and Rutherford laboratories. And most of the people now making MRI magnets in America came from the fusion research programme.

Schenectady,
New York

JAY BENESCH

Ringing the changes

SIR—Concerning public telephones (March 12th), two things strike the visitor to Britain from Japan: not only do British payphones not work, but there are so few of them. Britain, you say, has 79,000. In Japan there are 800,000. Needless to say they all work.

The fewer the phones which work, the quicker they fill up with coins, the more profitable they are to steal from. Because of the greater nuisance value, they are also more fun to vandalise.

Britain needs many more public telephones and these must be carefully sited in "defensible space": for example, under the eye of shop cashiers, railway-station staff, in police stations and all-night shops and garages.

If British Telecom will not empty the coin boxes before they fill up, why not contract out to someone living near the call box, who could receive a percentage of the takings and would thus have an interest in keeping a watchful eye on his fief?

Kangawa,
Japan

PATRICK CAI

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DIRECTOR, PROGRAMS (REF 201E)

AND

DIRECTOR, FIELD OPERATIONS (REF 202E)

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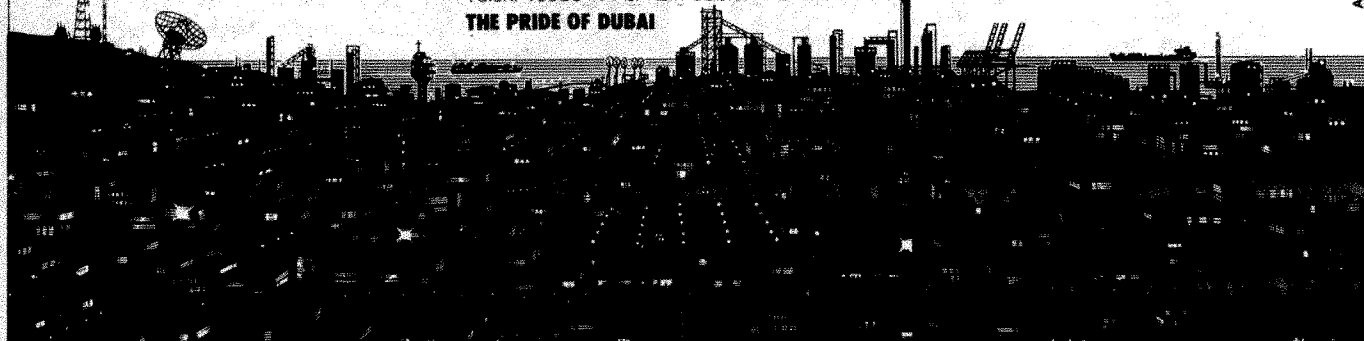
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Wunderkind at 40

WEST Germany is rich, clean and politically stable. It is capitalism's third-biggest economy, and keystone of the western alliance. What happens there matters, in a big way. Right now, little of what is happening is good.

The country is no longer getting richer as quickly as it used to, as it should be, or as nearly every other economy is. Nobody understands this better than the Germans themselves, who are engaged in a national brooding. This mood should not be dismissed as merely another upswing in the country's *Angst* cycle—though it is that as well. By 1990 West Germany will have a full decade of economic under-performance behind it, with the causes more or less acknowledged but the will to tackle them hardly any stronger than in 1980. Soon it may no longer seem outlandish, as it still does in 1988, to extrapolate the past and point to a Germany that is not merely static but, by comparison with its European neighbours, sick.

Between 1980 and 1987 West Germany's output grew by 1½% a year, the slowest of the five largest OECD economies. Growth prospects for 1988 are not as gloomy as they seemed a few months ago: the country's big forecasting institutes now expect a rise of 2% or so. However, that is still less than the growth predicted for America, Japan and Britain, and in 1989 the institutes expect German growth to slip back to only 1.3%. Unemployment is set to stay above 2m and will probably rise. Investment is sluggish, and likely to remain so. The

country's virtual price stability is less of a distinctive achievement now that inflation has fallen everywhere else too. Weakening demand for exports, thanks mainly to the collapse of the dollar, has stalled the traditional engine of growth.

Facing exactly the same external pressures after 1985, Japan responded with a flexibility that stands in sharp contrast. Its government was able to agree on a fiscal boost, and then carry it through. Its companies moved swiftly to cut costs and to find new products and markets. West Germany's government fussed endlessly over tax cuts, most of which have yet to appear—and which are planned to deliver virtually no expansionary impulse when they do. It rejected stimulus by extra public spending because of justified worries over the effect that an aging population will eventually have on its budget. Its central bank rules out any further monetary easing for fear of adding rising inflation to the catalogue of ills. Meanwhile most German companies have battened down the hatches and are waiting for something to turn up.

One element of West Germany's 1980s malaise is therefore that its conservative government—unlike Britain's, for



instance—really is conservative. In macroeconomic policy this inertia has generally proved to be a blessing, and will again. A simple but reliable macroeconomic rule is to aim for slow and stable growth in total demand, with long-term success judged by the resulting inflation rate. However inconvenient it may be, the lesson of the 1970s was that macro-policy has no lasting effects on growth, employment or investment; governments that think otherwise jack up inflation rates, but have nothing else to show for their endeavours. True, demand

in West Germany has been too tightly squeezed by the currency's appreciation, so there is room for a gentle, non-inflationary stimulus from government. But West Germany's real troubles lie elsewhere, in the microeconomics of firms and markets. That is where stability—read paralysis—is such a nuisance, and becoming ever more so.

The economy has a bad case of what used to be called "industrial policy"—a largely incoherent regime of subsidies, regulations and state-run enterprises, all paid for by high taxes. In most other OECD countries, governments—conservative and socialist alike—have been deregulating, privatising and cutting taxes. Mr Helmut Kohl's government has done very little. Many of its subsidies to farmers, steelworkers, shipbuilders, coalminers and the rest have increased. State enterprises continue to be shielded from competition. Reform of the Bundespost, for example, has been demanded for years. A twice-enfeebled plan is now under attack from politicians of left and right: too controversial, they say. The price for all this public-sector inefficiency is rates of business and personal taxation which, even after the promised changes, will set West Germany apart from its competitors in the 1990s as obtrusively as its low inflation did in the 1970s.

Tough choices ducked on defence too

None of these economic failings will be put right easily, because the government is less to blame than the system of government. The combination of a federal structure and a splendidly democratic voting system gives Mr Kohl far less power than, say, Margaret Thatcher has. The states, through their representation in the Bundesrat, have just demanded 70 changes in the proposed tax reform; later they will be able to veto the plan altogether if they wish. The voting system, meanwhile, ensures that the federal government is bound to be a coalition, usually involving the middle-of-the-road liberal party. Compromise, stability, consensus, yes. Economic reform, however badly needed, no. The attributes that served German economic policy so well for so long are now pointing

the way to relative decline.

Well-earned laurels rested on too long, and too comfortably; a political structure good at dealing with the familiar, but bad at coping with the novel. Those two things make West Germany's allies worry about its foreign policy as well as its economy. Mr Kohl has more or less delegated foreign policy to Mr Hans-Dietrich Genscher, his foreign minister, and a leader of those middle-of-the-road liberals. Mr Genscher's Free Democratic party is the kingmaker of West German politics. It put Mr Kohl into the chancellorship by turning its back on the Social Democrats; it can put him out by swivelling round again. Mr Genscher is also the most popular politician in the country because he is the voice of the comfortable majority who do not want to admit that circumstances have changed, that unpleasant new decisions may be needed. He rationalises the easy option.

The West Germans built themselves into the West in the 1950s. They opened a window to Brezhnev's East in the 1960s and 1970s. They are entitled to be pleased with both *Westpolitik* and *Ostpolitik*. What they need now is a *Gorbachevpolitik*, and they do not have one. Genscherism believes that Mr Gorbachev is honest when he says he wants to rescue the Soviet economy, and that he will cut deep into the Soviet army to do so. It is right on the first count, and may one day be proved right on the second.

But the danger in Genscherism is that it acts as if Russia's disarmament were already under way. It is not. Russia's su-

periority in most non-nuclear weapons in Europe has grown steadily during Mr Gorbachev's three years in power. Coupled with the possibility that America will soon pull some of its troops out of Europe (see page 31), this means that West Europeans have to provide more of their own defence until and unless Mr Gorbachev starts army-cutting of his own. So far West Germany will do nothing more than improve its military co-operation with France. That may get French troops into the battle for Europe a couple of days earlier than before. It does not add a man or a gun to Europe's protection.

As if this frailty in conventional forces were not serious enough, the Genscherites are now tempted to cut the nuclear weapons that stiffen the front in central Europe. The common man's commonsense disarmament agenda is one which starts with an attempt to see whether Mr Gorbachev is willing to equalise the armies in Europe, and then decides how much nuclear stiffening is needed. Mr Kohl's own party, and most European governments, can see that. The Genscher people would prefer, it seems, to press ahead with nuclear cuts regardless. That is too big a bet on Mr Gorbachev.

It is unfair to blame Mr Kohl for all this. He is a comfortable fellow, who likes the relaxed approach to governing. The trouble is that the country he governs has slipped from keen young muscle to easy middle-aged flab, and its system of government includes such a tangle of belts and braces that a regime of toe-touching and knees-up has become desperately difficult. *Wunderkind* at 40 is a worry.

Alas, poor Marx

And Marx begat Lenin, and Lenin begat a mess, and here are the latest three struggles to get out of it

AFTER more than 70 years of believing themselves to be the vanguard of history, communists the world over are slowly waking up to the bitter reality that they are bringing up the rear. From Budapest to Beijing, they are being pulled along by events, not controlling them. The bravest are beginning to accept that they—and Lenin—are to blame.

It was Lenin who invented the modern communist party and laid down the rule that it must have both a monopoly of the truth and a monopoly of power to enforce the party line in every nook and cranny of society. The idea that such a know-it-all, control-it-all sort of party is not best suited to running complex economies in times of rapid technological and social change is hardly new. What is new is that the seeds of doubt have now been sown in the minds of those in power, not just those ejected or excluded from it. In three countries—Hungary, Russia and Poland—the doubts are currently producing different responses (see pages 47-49).

In each case, what has brought on this fit of fallibility is the visibly widening prosperity-gap between the increasingly sluggish communist-run third of the world and its nimbler capitalist two-thirds. Throughout Eastern Europe and the Soviet Union economic growth is so slow as to be barely measurable. After decades of broken promises of the better life, communists are being called upon to explain themselves.

In Hungary, which has worked hardest at economic reform, a combination of rising debt and inflation has led to the sort of austerity package that politicians elsewhere have nightmares about: tax reforms have squeezed some Hungarians' real pay-packets by as much as 50%. Anger at the economic squeeze, plus a feeling that, after 20 years of attempted reform, Hungary has simply outgrown the communist party's ability to run the place, has produced barely veiled calls for the party leader, Mr Janos Kadar, to step down.

Bending till it breaks

Luckily for Hungary, some party men, including the prime minister, Mr Karoly Grosz, realise that pasting up a fresher face (even Mr Grosz's) on party billboards will not solve the problem. They are beginning to see that, if Hungary is to survive the buffeting to come without a Polish-style upheaval, the party will have to make space for—even possibly share some of its powers with—the new groups that have sprung up to represent the interests of ordinary Hungarians. The dialogue between rulers and ruled has been encouragingly polite. But it has bent Lenin's party monopoly about as far as it will go. Will Hungary's be the first communist party to have the courage to break it?

There are echoes of Hungary's debate in Moscow, but



with a difference. Hungarians are looking for ways to uphold the theory of party control, while in practice nudging the party to the sidelines. Russia's Mr Gorbachev is a true believer in Leninism. Since the party is in charge, he is prepared to see it take the blame for the economic mess the country is in. He blames Stalin for corrupting the revolution and Brezhnev for letting the party slip into venal and bureaucratic ways. But his solution to Russia's political-cum-economic crisis is a reshuffle within the party, not a democratic challenge to party rule. Thus the heavy-handed "state socialism" of the past 50 years is condemned as a travesty of Leninism, not as a consequence of one-party rule. And even that goes too far for some. Conservatives will try to block Mr Gorbachev's reforms at next month's special party conference.

Assume that he manages to bring in some new faces next month, and make some bits of the party more accountable to other bits. Mr Gorbachev will not have mended the mistake in Leninism. An all-powerful party, accountable to nobody

but itself, will sooner or later slip back into bad old ways. For a reminder of just how bad things can get, look at Poland.

Poland's communist party had all but bankrupted Poland before it was challenged by Solidarity in 1980. What Solidarity wanted was not to abolish the party, but to hedge it in with checks and balances and so save Poland from another economic disaster. The strength of the Solidarity idea was so great that only martial law saved the party from having to accept Solidarity's terms. Eight years on, the economic sacrifices made by Poles since then have again been wasted by the party. The new round of strikes is a mark of ordinary Poles' bitter desperation.

Everywhere, communists are facing a challenge to their Marx-and-Lenin-given right to rule. Several parties have started ditching the dottier economic theories of Marx. None has yet dared to debunk the political theories of Lenin. Unless they do, communism is for the scrap-heap. But, without Lenin, what is communism anyway?

Every peace has a price

An end to Angola's war would still leave that unhappy country in South Africa's orbit

TO SWEEP the Russians from their far-flung outposts is a respectable American ambition—even a philanthropic one, since poor countries get poorer still by running their economies the Soviet way. Now that Mr Gorbachev's team is clearing up its own debris in Afghanistan, the Americans may soon be able to put another broom in the cupboard. In London on May 3rd-4th the two superpowers and South Africa sat down with Angola to work out the future of that unhappy country, Russia's collapsing last bastion in southern Africa.

Angola's civil war began when the Portuguese walked out in 1975, leaving three factions fighting for control. The Americans backed one, the South Africans another; the third, in the capital, was supported by Russian experts and Cuban fighting men, who held off its enemies and won it recognition as Angola's government. It has been able to survive as the government only with continued communist help: at this week's London meeting a Cuban minister was part of the Angolan delegation.

If Russia and Cuba wash their hands of Angola, the Americans' limited political interest in the place will wane. They feel uneasy there. The local faction they first supported fell apart long ago, so they switched to supporting the South Africans' favourite resistance movement, UNITA. This partnership upsets some members of America's Congress. Now that the Angolan government has started to turn its back on Marxism, it is getting harder for the Reagan administration to justify its support for the UNITA rebels, even though they clearly speak for a large chunk of Angola.

The London talks are supposed to lead to the withdrawal of all foreign troops and weapons from Angola. If the Cubans quit, they go right back across the Atlantic. If the South Africans leave, they merely shift across the border into next-door Namibia which (with its diamonds, copper, uranium and so

on) they hamfistedly rule in defiance of international law and frequent United Nations resolutions. The Angolans do not want to lose their Cuban guard while the South Africans can easily roll back in again. Any workable Angola deal must get South Africa out of Namibia too.

Between the South African devil and more seas of blood

The Americans have a double objective. They say the Cubans should move out of Angola at the same pace as the South Africans leave it and Namibia. The South Africans have half-promised to accept something like this. Meanwhile, say the Americans, Angola's ruling clique should fix up a coalition with its UNITA enemies, under the leadership of Mr Jonas Savimbi. The shrewd Mr Savimbi has grown more pro-American since his South African-helped offensive, which was meant to capture almost half the country, was blunted at Cuito Cuanavale at the turn of the year. He remains a formidable figure, with a claim on Angolan politics.

The Americans, Russians and Cubans understandably want to walk away from the whole mess. This would leave South Africa the undisputed power in the region. The region's black governments know what life in a backyard can be like. Nobody could stop South Africa overawing all the black states to its north, including an independent Namibia. One of those states, Mozambique, is already so badly wrecked that its government begs for South African co-operation. So some people would prefer to keep the Americans involved, even if this means coaxing the Cubans and their Russian bosses to keep a justifying foothold in the area. But this would also mean keeping the war going. Better peace, and an Angola and a Namibia without foreign soldiers, and with something nearer decent government than they have yet had.



Arctic antic

Please, Canada, do something useful with those extra defence cents

UNDER pressure from both Mrs Margaret Thatcher and Canada's Mr Brian Mulroney, President Reagan has promised not to oppose Britain's bid to build nuclear submarines for Canada. The president's decision—to allow the transfer to Canada of the American reactor technology that Britain now uses—must be approved by Congress, and probably will be. Britain therefore catches up with France in the competition to build the first of ten or a dozen nuclear attack submarines that Canada says it will buy. But why on earth does Canada want them?

The most that can be said for this plan of Canada's is that it shows that someone is still awake in its defence ministry. After years of rock-bottom defence spending and cuts in Canada's commitments (at any rate, the important ones: the Canadians still keep large numbers of officers pushing paper on NATO staffs), Canada's allies were at first pleased when its conservative government last June published proposals to increase defence spending by 2% a year in real terms for 15 years, to replace the out-of-date equipment of all Canada's armed forces. Unfortunately, the centrepiece was this astonishing plan to acquire the nuclear (propelled, not armed) submarines. The first would be bought from a British or French shipbuilder, and later ones built in Canada.

Under-ice follies of 2010

The submarines are supposed to be needed to patrol the sea under the ice north of Canada, which Canada claims for its territorial waters and the United States says are international ones. This justification appeals to the anti-American plasma that flows through many Canadian veins, and it thereby gen-

erated a bit of political support for the increased defence spending. President Reagan has decided not to be cross about this—his advisers whisper that if a war comes, NATO can soon get the submarines out of the ice-water and into the Atlantic where they can be of some use—but other people should object. Canadians have many reasons to resent the Colossus of the South, but it can do neither them nor the alliance any good to spend so much money feeding their resentments.

At something like \$550m each, nuclear submarines are not cheap—and this is without counting the cost of the elaborate infrastructure that any country must build in order to operate them safely and efficiently. Canadian officials admit that they drew up the plan for 10-12 submarines with much idea of the total cost. They were taken aback when British mathematicians totted up the probable all-in figure.

The result will almost certainly be a cut in either the number of submarines (to maybe four or five plus infrastructure) or in other parts of Canada's armed forces. If at last Canada is to start pulling its weight in the alliance, there are much better uses for its money: such as putting an armoured division or two into West Germany, instead of the lonely little brigade it has there now. This would also be quicker. A new division could be in place in a couple of years; it will take until well into the next century to build a nuclear-submarine fleet. Let Canada concentrate on getting its defence spending up to the level of at least West Germany's (around 3% of GNP; Canada's is barely 2%) and on building up its European land and air forces to a useful level—about five times what they now are. Then, if it still sincerely wants to join the nuclear-submarine club, that contribution will be much appreciated.



Two laws for Lloyd's

Filling the regulatory gaps in London's insurance market

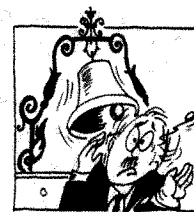
PROFESSIONALISM, quick-wittedness, innovation, security. Despite the scandals of the past decade, these are some of the qualities that are helping Lloyd's of London to maintain its pre-eminence among the world's insurers. It is computerising its 300-year-old market, embracing the latest technology in most of its business, and gearing up for 1992 when European barriers to free trade in insurance are supposed to come down. Unfortunately, its treatment of its long-suffering investors—the "names" who back the market with their wealth, and without whom Lloyd's could not exist—remains as out of date as it was in the late 1920s.

Just over a year ago, Sir Patrick Neill's report on Lloyd's and self-regulation criticised the \$15-billion-a-year insurance

co-operative's investor-protection rules. Sir Patrick made a fistful of suggestions, most of them anodyne. Under pressure from the government, Lloyd's half-heartedly committed itself to adopting them. Now it is wholeheartedly refusing to implement two crucial recommendations: about a deficit clause and abandoning "pay-now-sue-later" operations. Both relate to the agency agreement—a contract as legally binding as any between an investor and his agent.

Tails you lose, heads I keep winning

As other reports on Lloyd's (Cromer, Fisher and Barber) have done before, Sir Patrick said a so-called deficit clause should be introduced into the agreement between names and manag-



ing agents who run syndicates on behalf of names. Broadly this meant that the syndicate profits and losses of names, who are usually placed on several different syndicates, should be lumped together in computing any commission on profit they pay to agents. At present, agents take a commission on those syndicates where there is a profit, even though the name may show an overall loss on all of his syndicates.

The Neill report also suggested a tempering of the "pay-now-sue-later" clause in the agency agreement, under which agents have an unqualified right to borrow money on behalf of names without any reference to them. At present, if things go wrong (even as a result of fraud), names can be wiped out without their knowing it. Their only redress, after the event, is to sue the agent, usually a partnership or limited company which anyway may not have either the capital base or sufficient insurance to meet big claims. When a name is in dispute with his agent over a call for money, said Sir Patrick, the cash should come from Lloyd's central fund (set up for the protection of policyholders) until the matter is resolved in the courts or through arbitration.

Lloyd's has decided that neither of these safeguards will be implemented. This is morally wrong, and economically

short-sighted. Lloyd's, for most of this century a giant tax-avoidance scheme, was an attractive proposition to the wealthy when top personal-tax rates were penal (as high as 98% on investment income). It will become much less attractive now that the top tax rate is 40%. It cannot afford to make itself still more unpopular, by denying names the same protection as other investors in City markets have under the Financial Services Act.

The fundamental conflict of interest in Lloyd's (and one which will not go away) is how to protect the interest of names and at the same time protect the interest of policyholders. Lloyd's has demonstrated that it is either unwilling or unable to reconcile this conflict. One answer is to formalise its dual regulatory role. Wearing one hat, Lloyd's looks after the interests of policyholders and remains answerable to the Department of Trade and Industry; wearing another, it looks after the interests of names and is responsible to the Securities and Investments Board, the City's overall watchdog. Mrs Thatcher's government warned Lloyd's that if it did not implement Sir Patrick Neill's proposals on investor protection then the government would introduce some form of statutory control. Lloyd's has not; so the government should.

Gilded youth

"Britain's students should not be subsidised by the state." Discuss

UNIVERSITIES were once finishing-schools mainly for the teenage children of the rich. At different times this century, Japan, America and most West European countries managed to broaden the range of teenagers admitted, at least to include the children of skilled manual workers, if not of the lumpen proletariat. Britain has gone down this road too, but not nearly so far: only 14% of its 18-21 year-olds are at universities and polytechnics. Now its government is willing, in principle, to open up higher education to more teenagers, and to their parents. To do so without overhauling its finances would be ruinous.

The government is doubly generous to young British students. It pays for them to study in small classes. And it gives them grants to support themselves, subject to a means-tested contribution from parents. One way of expanding higher education without spending more would be to increase student-staff ratios; polytechnics have already done that without any noticeable decline in standards. But British professors shudder when they visit their overstretched colleagues in France, and Americans worry that they too have sacrificed quality of higher education to quantity. Any increase in British class sizes will therefore be cautious, and rightly so.

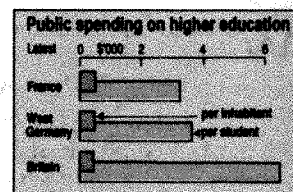
Bigger savings could be made by cutting the largest of the many direct subsidies that Britain's welfare state makes to the middle classes: student grants. After nine years of toying with the idea of student loans, the government is at last preparing to introduce them in a modest form—as a top-up to a depleted grant. The case for doing this is strong, because an 18-year-old Briton deciding to forgo a wage in favour of a grant to

invest in higher education can expect an excellent rate of return—as high as 20%—in the form of much increased earnings over his working life. Some of that gain should be recouped from the student.

The obvious way would be to scrap grants altogether, replacing them with soft loans—and strong incentives for rapid repayment. The government is not going nearly so far. Its proposals will not produce any financial savings for at least eight years. Ministerial caution stems from political sensitivity to middle-class constituents, but there are other, better reasons not to switch to an all-loans system too quickly. The main one is that, far from encouraging more working-class children to continue their studies, loans would put them off. The daughter of an uneducated miner grows up with far less direct evidence of the value of human capital than a lawyer's son; it can take a generation of expanding opportunities to change such attitudes. Fortunately, in the next ten years it will be possible to educate a larger proportion of teenagers at no extra cost, because there will be fewer of them.

Grants at 16, fees at 40

More imaginative policies are needed to coax children from poor families into higher education. The government could give them a grant to stay on at school after the minimum leaving age of 16, paid for out of money hitherto spent on 16-year-olds who are unemployed or on training schemes. Children who then need encouragement to go on to university should be given full grants for their maintenance; those who do not should be offered loans only. One formula would be to give



maintenance grants only to students whose parents have not been to university. Such a system would gradually become cheaper as the population became more educated.

Having established the principle that some students should invest in their own education, the government needs to think again about how to subsidise tuition fees. Privately, some ministers would like to allow universities to charge fees to some undergraduates, if only to enable them to offer better-than-average courses in expensive subjects. That bad idea demonstrates the disadvantage of charging teenagers for tuition. For young students without clear career ambitions, fees tend to encourage them to choose cheap courses, such as English, in preference to dearer ones like engineering. Twenty-first-century Britain should be looking to its engineers.

A better way of getting more private money to pay for

tuition would be to open up access to higher education for the people most likely to want to invest in themselves: adults wanting to upgrade their skills. The financial fortunes of a college such as Birkbeck, London, which teaches mature (and mainly part-time) students, should not have to depend on the whim of a university grants committee geared mainly to financing full-time undergraduates. Mature students willing to support themselves while studying and to pay a certain proportion of their tuition costs should have the rest paid by the government. That would allow new Birkbecks to spring up, at a relatively low cost to the Treasury. It would also emphasise a principle, largely unknown in British higher education, of state money following student demand. And it would be part of a broader process: of universities in Britain becoming the economic and social ladders that they are in other countries.

Yearning to breathe free

How Europe—and others—could welcome refugees without provoking Le Pen

WAR, famine and oppression have always forced people to flee from their homes, but today's refugees are more numerous (roughly 12m) and harder to resettle than ever before. All civilisations gained because outstanding and therefore persecuted people like seventeenth-century Puritans and mid-twentieth-century Jews found homes in the New World, instead of some immigration officer in civil-service grade D4 shunting Einstein back into the holocaust. Yet most western governments have now taken to thinking that any dark-skinned asylum-seeker is fleeing from poverty, not persecution. What they fear—an influx of the world's poorest people, posing as refugees—is pure fantasy.

Asylum-seekers have not come rushing from the horn of Africa or wretched Bihar. People who are really starving cannot afford to jump on aeroplanes. The 5m Afghans in Pakistan and Iran want most to return to their own country. The groups whom third-world dictators or majority tribes persecute first are the merchant classes bright enough to oppose or show them up, rather than the massed miserables in their societies. The Ugandan Asian shopkeepers or Tamils or Indochinese boat people are likely to be more entrepreneurial than the average citizen in the Stepneys where they try to settle, as were the Jews before them. This sounds marvellous for the host country, but is resented in Stepney. The resentment is fanned by Le Pens who get 14% of the national vote, which other politicians then shuffle to appease.

That is why a red-carpet welcome for all who call themselves refugees is sadly not the most humanitarian policy now, because people in genuine physical danger would fall foul of the tighter controls that would follow the backlashes. The quiet descent into unintentionally murdering Einsteins starts when refugee policy becomes an extension of immigration policy. By using narrow criteria that are almost impossible to prove, countries like Britain slide into making arbitrary decisions about whom to let in. When any official is allowed to judge which individuals might integrate most smoothly into

Ealing, he turns away the most desperate first.

Every decent country now needs to formulate a refugee policy, quite separate from its immigration policy. The EEC is about to face this test, and miserably to fail it.

EEC countries have to co-ordinate their refugee policies before all their citizens get a single European passport in 1992. So far the bureaucrats concerned have looked mainly at ways of standardising restrictions. Anybody denied asylum in one member state, it is suggested, would not be able to seek it in the others. All Europe's rules would then drop to the level of the most Le Pennish.

A competitive European asylum

There is a politically acceptable alternative, and Europe needs a lobby to advocate it. One EEC official should be called a commissioner for refugees, with a refugee defined as "anybody who, owing to events disturbing public order, is compelled to leave his place of habitual residence". The commissioner should keep a changing register of the groups who most need asylum. Tomorrow it might include, as well as Tamils and Punjabis and Lebanese, communist ex-apparatchiks who would otherwise be hung from lamp-posts in Estonia, white South Africans, Armenians, God knows who; but it will be unsurprising if frightened dark-skinned people continue to predominate for a while.

The EEC should levy an annual charge on member countries which, per head of their own population, take fewer than average of these listed refugees, and pay money to those which take more. Ideally, the fee should be high enough to encourage countries to market themselves as attractive asylums, but even a weaker scheme would shame some reforms from countries that were regularly paying the levy. This is one of several EEC conventions that should be open for co-signature, either as asylums or payers, by some other rich countries. Including, Australia, Switzerland, Canada, Japan.



ENGLISH LAWYERS



Waking them up

The restrictive practices of lawyers in England and Wales, which date back to the eighteenth century and beyond, cause inefficiencies and over-pricing. The British government is preparing to challenge them. What needs to be done?

THE legal profession (along with another 16 professions) is exempt from the provisions of the Restrictive Trade Practices Acts of 1976 and 1977. After a government green paper (discussion document) on restrictive practices was published in March 1988, Lord Young, the secretary of state for trade and industry, said that in future exemption would be granted only sparingly.

will the privileges of the legal profession
Don't bank on it.

Lawyers defending their restrictive practices will get a more understanding hearing from the government than did the coalminers or the Fleet Street printers. There are 27 barristers and 18 solicitors on the government backbenches in the House of Commons and five lawyers in the cabinet, including Margaret Thatcher herself.

Archaic who-does-what rules divide lawyers in England and Wales into two categories: solicitors and barristers. The mouth-piece for solicitors is the Law Society; for barristers, the Bar Council. Each wants change for the other. Where changes are being made, they often serve to perpetuate restrictive practices, not to abolish them.

Parliament is confused, when it is not inert. Since the 1960s there have been umpteenth inquiries into various aspects of the law, ranging from rules of evidence to police

powers. Many have been concerned with the law; not enough with lawyers and legal services. When, in 1979, a royal commission did report on lawyers it recommended that the status quo should remain. The government accepted the proposals in 1983.

In 1986 another committee was set up—this one under Lady Marre, with five barristers, five solicitors and five outsiders. Briefed to look at virtually any problem relating to the two branches of the profession, including job demarcation, the committee is expected to report soon.

Ever solicitous

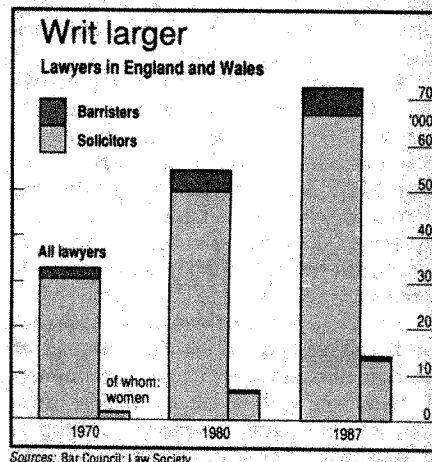
The structure of the legal profession has hardly altered in 200 years. Solicitors form its junior branch. A solicitor serves his (or, increasingly, her) time as a student and then as a trainee solicitor (what used to be called an articled clerk) before being issued with a practising certificate from the Law Society.

Business is booming for all lawyers, especially for solicitors. Legal journals talk of a "recruitment crisis" despite the increase in their numbers. In 1965 about 20,000 solicitors were in private practice in England and Wales. By 1979 there were more than 30,000. Today, 40,500 solicitors are in private practice. In the 1985-86 tax year their gross fee income was £2.26 billion.

Incomes vary widely, even for those solicitors who have much-sought-after expertise. A young lawyer with, say, eight years' experience in commercial property can command up to £30,000 a year in the Midlands, and half as much again in London. The big corporate law firms (like Slaughter & May, Herbert Smith, and Freshfields) have benefited mightily from a greater reliance on lawyers' advice in business dealings and the trend away from my-word-is-my-bond assurances towards statutory regulation of banking, insurance and the financial markets.

Solicitors claim they compete more than barristers. They cite, for instance, the law abolishing their monopoly on house conveyancing. The claim does not survive scrutiny. Provincial solicitors, who depend on conveyancing for 40-60% of their fee income (and also run the Law Society), defeated the most threatening legislative proposal introduced by Mr Austin Mitchell, the Labour member of Parliament for Grimsby: that solicitors employed by banks and building societies should be allowed to do conveyancing work for these institutions' own customers. The law eventually passed said that such institutions could offer conveyancing only when they were not the lender of the mortgage money. Not surprisingly, none of these financial institutions offers such a service to non-customers. In consequence, the conveyancing monopoly of solicitors remains virtually intact.

The Law Society recognises that the conveyancing monopoly cannot survive indefinitely and so is trying to swap this restrictive practice for another. It recently allowed solicitors to incorporate and also to enter into arrangements with, for instance, banks and building societies for the introduction of business. Official approval of this practice will make it more widespread. The risk is that it could curb competition as fi-



financial institutions begin routinely to refer customers to their associated solicitors. Sometimes the influence may be less subtle than that. Some public-minded lawyers fear that applicants for mortgages will be told they must use a particular firm of solicitors.

A reform which would benefit the clients of solicitors has meanwhile been shelved—the formation of multi-disciplinary partnerships to provide one-stop professional services. The idea was originally floated to meet competition from diversifying accountancy firms. For solicitors to turn themselves into such enterprises, they would need to tie up with accountants, merchant banks and stockbrokers.

Although the big City of London law firms liked the idea, the provincial solicitors again scotched reform. They say that mixed practices would not be in the best interest of clients. What they really mean is the best interest of provincial solicitors, who count on conveyancing for much of their income. If multi-disciplinary partnerships were allowed, it would be difficult for solicitors to continue to maintain that building societies and banks should not be allowed to offer legal services to their customers.

Propping up the Bar

The gentlemen of the legal profession are barristers. Their apprenticeship is served at one of the four Inns of Court in London—Lincoln's Inn, Gray's Inn, Middle Temple and Inner Temple—where quaint practices and rituals set them apart from lesser lawyers. Since 1965, when there were about 2,000 barristers at the Bar, the number has almost trebled to 5,600 (of whom 747 are women), but their workload has increased even more. The civil legal-aid budget, for instance, increased fourteen-fold between 1966 and 1983 and the criminal legal-aid budget from £550,000 to £62m.

Yet almost half the barristers are low-paid. These are the 2,500 or so who practise at the criminal Bar, where juniors (who, confusingly, may be quite senior) earn on average £15,000-20,000 a year. It may take a newly qualified criminal barrister 10-20 years to build up a reasonable fee income; some at the top of the criminal Bar can clear £100,000, but they are rare.

Small wonder that many barristers do not practise at the Bar but go into industry and commerce, local government and the Inland Revenue. This "employed Bar" now totals 4,000. A recent report by P-E Inbucon, a group of management consultants, reckoned that the average salary of the employed Bar in 1987 was £30,000-32,000 a year, compared with £10,000-12,000 in 1978.

For those who stick at the Bar, the rewards can be substantial. Roughly half of the barristers practise in civil and commercial law, where they can earn more than £80,000 a year (after expenses). A few, perhaps six in any one year, earn up to £1m. At

the top of the profession, a commercial barrister in a difficult case expected to run for a fortnight can command a brief fee of £75,000, plus £1,250 a day. His junior, who does most of the legwork, would get £500 a day. The fee is discussed by the client's solicitor with the barrister's clerk: it is considered vulgar for a barrister to talk about how much he will be paid.

Within the Bar itself there is a strict pecking order. The profession is divided into junior counsel and Queen's Counsel (also known as leaders or silks). Barristers take silk for two reasons, apart from the prestige it brings. They can charge more for their services and it also opens up the possibility of becoming a judge. For it is only from QCs (at last count there were 584 working QCs, 21 of them women) that the Lord Chancellor selects high-court judges.

Because high-court judges, who earn £65,000 a year, are scooped from such a small pool, there are simply not enough for the workload—one reason that cases take so long to reach the courts and, when they get there, can run almost as long as Charles

Dickens's *Jarndyce v Jarndyce*. Much recent progress has been made in cutting the time taken for routine court actions. But pre-trial proceedings can still be long-winded. One lawyer reports that a complicated commercial lawsuit he has just launched might not reach the courts until 1992; plaintiffs who recently began a product-liability suit against makers of tranquilisers have been told that the case might be heard in 1990.

Barriers to competition

The demarcation between barristers and solicitors and other restrictive practices in the profession inflate legal bills by curbing competition among lawyers, confusing their clients and requiring the employment of two or more lawyers when one would do. The lines between the two parts of the profession are already becoming slightly blurred—for instance, some newly qualified barristers are practising as solicitors and not at the Bar. (In theory, a barrister must be disbarred before he can work in a solicitor's office.) In time the distinction should disappear altogether. It is one of several changes that are needed for a less expensive, more efficient and more user-friendly system of justice, starting with:

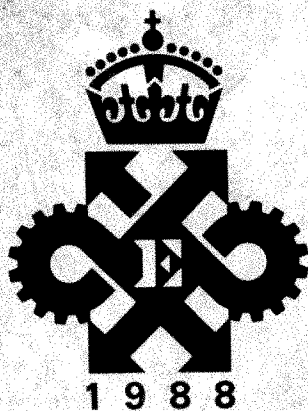
- **Barristers'-cum-solicitors' offices.** Barristers opposed to the change say that practices that included both solicitors and barristers would charge their clients more. A divided profession, they say, means that a solicitor secures the services of a barrister who possesses the skills to suit his client's particular needs. They claim that if barristers moved from their spartan "chambers" into usually plush solicitors' offices it would add to overhead costs (and charges to the client). Also, since the shared practices could not afford to have lots of barristers with specialist skills, the client would be referred to an in-house generalist. These arguments would carry more weight if barristers were willing to put them to the test by permitting the formation of all-rounder firms, so giving the public an alternative.

If nothing else, such firms would ease the acute accommodation problems that cause many barristers to abandon their ambition to practise at the Bar (and so keeps the number of barristers in artificially short supply). It is extraordinarily difficult to be a practising barrister without belonging to a set of chambers—and, in London, extraordinarily difficult for chambers to be outside the Inns of Court. As a result, "tenancies" in sets of chambers are notoriously hard to find even though some sets now have many more barristers than rooms.

Allowing barristers to incorporate is essential for the merger of chambers and solicitors' offices. Until recently, under Bar Council rules, each barrister worked for himself alone. He still cannot go into partnership or incorporate but is allowed to "share purses". Solicitors are already al-



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ENGLISH LAWYERS

lowed to incorporate but not so as to avoid personal liability. Allowing barristers to do so too would simplify life for the client. He would then instruct the company, not a particular barrister via a solicitor, and the company would charge him.

Solicitors and barristers sharing practices might also help to demolish the rules of the Bar which restrict

● **Public access to barristers.** Solicitors deal directly with the public. Barristers do not. When a client needs an assessment of the chances of winning a legal action his solicitor seeks the opinion of a barrister. In effect, the solicitor is saying to his client: "I don't know the answer but I know a man who does. You will have to pay him—and also me for arranging an introduction." Even then, legal etiquette dictates that the solicitor and his client visit the barrister at his chambers; it is unusual for the barrister to visit the solicitor.

The insistence on a solicitor acting as a middleman is a custom that looks increasingly odd in an EEC context. A British barrister active in the area of EEC law can receive instructions directly from lay clients when the instructions refer exclusively to his overseas practice. But when they involve an application to a court in England and Wales, Bar rules require the employment of a solicitor. The Bar Council has already made a concession to common sense in permitting members of other professions—including architects and accountants—to approach Bar members direct. This has made it harder to justify keeping other lay clients at arm's length.

Closer working relations between solicitors and barristers would also ease the eventual abolition of the barristers'

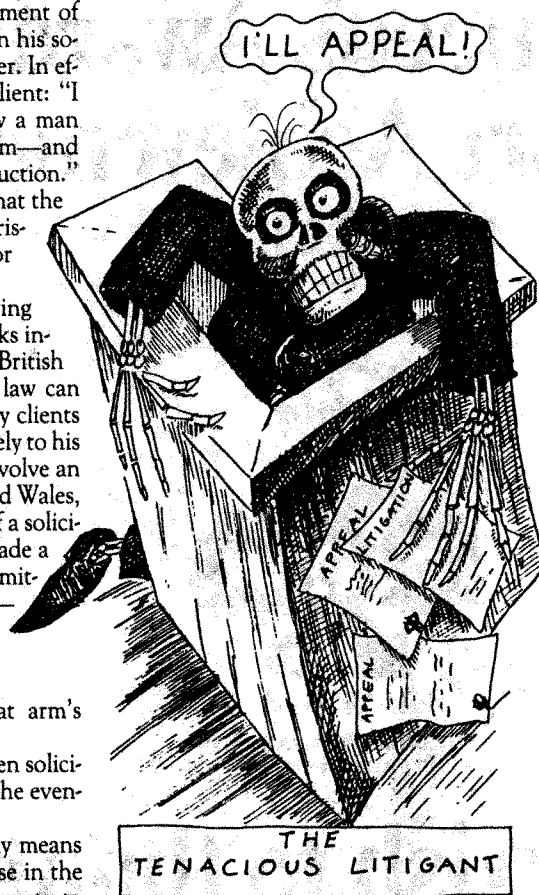
● **Right of audience.** This broadly means that only a barrister can argue a case in the higher courts unless the litigant wants to risk appearing in person. The monopoly is under attack. In 1986 the Law Society published a document stating more or less that it should cease. Barristers disagree. They claim solicitors lack their skills of advocacy. They may have a point, but again lack the confidence to put it to the test by allowing people the alternative of having their cases argued by a solicitor in the higher courts (barristers share the right of audience with solicitors in county and magistrates' courts).

Critics of the demarcation lines maintain that (especially in criminal cases) the barrister often knows too little about the case he is arguing, and usually less about the parties involved than the solicitor, who has prepared the case (and sometimes steered it through the lower courts). Yet, when a solicitor hires a QC for a client he will also hire a junior to assist the silk (most laymen are unaware that a silk does not have to have a junior; lawyers tend not to draw attention to this money-saving option). The legal hold-

ing-of-hands extends to barristers when they appear in the lower courts. A barrister acting in, say, a custody case in a magistrates' court must be assisted (or covered) by a solicitor.

Barristers have fought hard against any attack on their privileges in the higher courts because that might open the door to solicitors being appointed as

● **High-court judges.** This process is a bit



like the Dock Labour Scheme: only barristers are eligible and once appointed they have a job for life. Any cut in income that the barrister takes is offset (partly or wholly) by some substantial compensations: judges get a generous pension after 15 years on the bench and an automatic knighthood. In the lower ranks of the judiciary—eg, circuit judges, recorders and assistant recorders—the jobs can go to either barristers or solicitors. In practice, 90% of those appointed to such jobs are barristers. Some solicitors may sit as judges in, say, the crown court but—strange anomaly—have no right to appear as advocates in jury trials. Solicitors were originally barred from the bench because they did not have the necessary experience in advocacy. If they had rights of audience in the higher courts that objection, already questionable, would go.

If solicitors were eligible for appointment to the high court and court of appeal,

it would expand the pool from which judges are selected. That in turn might reduce the time between launching a lawsuit and bringing it to trial. But it would do little to widen the social circle from which judges are drawn (spasmodic surveys indicate that the fathers of nearly two-thirds of entrants into the legal profession are either professionals or managers). This is a serious weakness. Much of English law is judge-made law, and therefore bound to be influenced by the views (and class prejudices) of the judges. Young people from poor families are put off going to the Bar because they get an off-puttingly small income during their training and pupillage.

The burden on the courts might also be eased by allowing British lawyers, like American ones, to accept work on the basis of

● **Contingency fees.** This means that lawyers get paid if they win the case, but nothing if they lose. In America the practice is most common in product-liability cases where there is a claim for damages; the lawyer's fee is a percentage of the damage. Scotland, whose legal system is different from that of England and Wales, clients can agree to pay their lawyers a fixed fee if they win and nothing if they lose.

As a defence against contingency fees, some English lawyers point to the deluge of almost-frivolous cases in America. They also note that the legal system in the United States is notoriously slow and expensive. These are not trivial objections. If contingency fees were introduced in England and Wales, it would be prudent to introduce them on a trial basis.

Supporters of contingency fees say that they would quickly prove their worth by (a) clearing legal logjams, because they would lead to more out-of-court settlements; (b) persuading lawyers to be more diligent in preparing and conducting their cases, knowing that if they lost they would be out of pocket; and (c) avoiding frivolous cases in Britain where, unlike America, litigant the risk of being landed with their clients' costs. Contingency fees (which can never leave the client worse off financially) would also help weaken the case against permitting barristers to

● **Advertise.** A more competitive environment which gave barristers the right to advertise that solicitors already enjoy would help clients make a better informed choice. At present, unlike architects, barristers do not invite people to examine earlier examples of their work or refer them to previous satisfied (or dissatisfied) customers. Nor do they provide any literature on the services they offer. Altogether, it is ridiculously difficult to get any information on the relative merits of different barristers, except from other lawyers. A British government committed to competition needs to remind them that this is not 1788 but 1988.

ASIA



Showdown in Punjab

FROM OUR INDIA CORRESPONDENT

AFTER the murder of more than 750 people in the first four months of this year, the Indian state of Punjab has passed beyond the normal adjectives of anguish. India's prime minister, Mr Rajiv Gandhi, faces an appalling decision. Punjab is sliding towards terminal decline. Already the site of the world's bloodiest terrorist war, it may be heading for worse: a civil war that could threaten not only India's stability but the delicate peace between Pakistan and India. Can Mr Gandhi prevent it?

Punjab is India's richest state. It is also a place of seemingly unstoppable violence. The unhappy Indian tradition of people killing each other in the name of religion has turned into a daily carnage. Around 60% of Punjab's 19m or so people are Sikh, the rest Hindu. In the first three months of this year 578 Hindus and Sikhs were killed as they went about their daily business. After a comparative lull in the first ten days of April the rate of killing rose even higher: 176 people were slain between April 18th and May 1st. In 1986 terrorist killings claimed 520 lives, last year 1,280. If this year's rate for the first four months is kept up, more than 2,250 Punjabis will be killed in 1988.

Most of the killings have been carried

out by Sikhs who want Punjab to become an independent state, called Khalistan ("Land of the Pure"). Some murders, the utterly random ones, are intended to provoke more violence. On April 29th, after a bomb went off in the Hindu area of the town of Batala, enraged Hindus attacked Sikhs who had had nothing to do with the bombing. Other victims have been Sikh politicians or officials who might have been rallying-points for a return to peace.

The hard-core terrorists, once believed to number no more than 150, now exceed 2,000. The state's police force concedes that about 2,000 villages along the border with Pakistan have become "terrorist-infested". The terrorists' aim is to drive the remaining Hindus from these villages, a task they have nearly completed.

A new twist to the agony is the increasing flow of modern weapons across the border with Pakistan. In December the AK-47 automatic rifle made its first appearance in Punjab; it was followed by the RPG-7 anti-tank rocket, also Soviet-made, and other missiles. Last month the Indians discovered that the terrorists had acquired American-made Stinger anti-aircraft missiles. Members of the Indian government accuse Paki-

stan of complicity, a charge the Pakistanis hotly deny (while admitting that the long border is almost impossible to police). The Indians have deployed their paramilitary forces along parts of the frontier and have begun putting up barbed wire. Inevitably, if the terrorism continues unabated, India will move its army up to the frontier, obliging Pakistan to follow suit.

Mr Gandhi has tried a variety of policies, both conciliatory and tough. None has worked. On May 11th he will extend president's rule in Punjab—that is, control by the central government—for another six months. During this time Mr Gandhi aims to prepare the way for a new election in the state. The prime minister seems to be opting again for ballot-box politics, a year after the central government suspended the state legislature, deposed the elected Sikh government of Mr Surjit Singh Barnala, and gave the police a free hand to deal with the terrorists.

That move failed: the terrorists' ranks grew—because, in the clash of terror and counter-terror, the police used indiscriminate methods unsupervised by the courts—and the death rate shot up. Mr Gandhi conceded two months ago that the hard line had not curbed terrorism. At the beginning of March he released five Sikh high priests who were close to the militants, and four members and associates of the shadowy "Panthic Committee" which is co-ordinating the terrorism in Punjab. At the same time he held out an olive branch to the militants by releasing 42 of the 366 people arrested when the Indian army stormed the Golden Temple in Amritsar in June 1984; they had been held without trial in Jodhpur jail ever since.

Mr Gandhi had hoped that these moves would produce a group of Sikh leaders who, without being accused of weakness, would demand something less than secession. The high priests did condemn the killings, and tried to build support for a position that fell just short of a separate state. The men with guns, by increasing the kill-rate, made it clear that it was Khalistan or nothing.

This may have convinced the prime minister that he could not deal with the terrorists. But if the police cannot beat the killers, and trying to arrange a compromise with them will not work, to whom can the prime minister turn? On April 25th Mr Gandhi spent more than two hours with Mr Barnala, the first meeting since he bundled him out of power a year ago. The meeting was also attended by the former Maharajah of Patiala, a leader of the rival faction of the Akali Dal party. The Akalis split in May

1986, after Mr Barnala assented to a second entry into the Golden Temple by the security forces. Mr Gandhi would like the Akalis to reunite and take part in the state election he now has in mind.

The prime minister has thus returned to the policy of July 1985, when he signed the Punjab accord with the late Harchand Singh Longowal, then the leader of the still-united Akali Dal party. The accord was intended to save the wound inflicted on the Sikhs by the storming of the Golden Temple and the killing of 4,000 Sikhs in Delhi and elsewhere after Indira Gandhi was assassinated in October 1984. In the 1985 state election Mr Gandhi's Congress party put up only a token fight and the Akalis won an outright majority in the Punjab legislature.

Things seemed to be going well: terrorists killed only 61 people during the whole of 1985. Most of the disasters since then have occurred because the central government was unable to live up to the commitments Mr Gandhi had made to Longowal. It did not release the Jodhpur prisoners, did nothing to bring the killers of Sikhs in Delhi to book, and failed to transfer the city of Chandigarh to Punjab—it remains the capital of both Punjab and adjoining Haryana. The

Congress party believed that the transfer of Chandigarh would make defeat in a state election in Haryana a near certainty. Congress politicians also grumbled that concessions to the Sikhs would cost the party the Hindu vote throughout northern India.

In caving in to the importunings of his party, Mr Gandhi destroyed the platform on which the Akalis had been swept into power. Mr Barnala was called Delhi's lackey, and by March 1987 his position was becoming untenable. Direct rule by the central government followed, bringing Punjab to the brink of an insurrection.

The prospect of a fresh election soon will almost certainly bring more violence from the terrorists. Their aim will be to abort the election, force the central government to declare an emergency, and so, they hope, bring Punjab to full civil war. For Mr Gandhi's new Punjab policy to succeed will require a skilful combination of steely police work and political nerve of a kind Mr Gandhi did not show in Punjab two years ago, when the state had a better chance of peace. The failure of Indira Gandhi's Punjab policy helped to kill her. It may prove her son's most dangerous test.

Sri Lanka

Will they beat the clock?

FROM OUR CORRESPONDENT IN COLOMBO

ONE hurdle has been cleared. Neither intimidation by terrorists nor a boycott by the main opposition party prevented the government of President Junius Jayewardene from putting through the first stage of Sri Lanka's ambitious election programme for 1988. With little violence, a respectable 61.5% of voters in four of the island's nine provinces went to the polls on April 28th and, for the first time, elected provincial councils. Control of all four went to the president's United National party.

Provincial councils are the other half of the bargain by which India agreed to send troops to Sri Lanka last year to subdue the Tamil Tiger guerrillas. The aim of the councils was to give the Tamils of the Northern and Eastern provinces, where they are concentrated, a lot of autonomy, short of the independence the Tigers want. Last week's four elections were the first test of the de-

India's friend in need

FROM OUR PAKISTAN CORRESPONDENT

NOT content with having one finger in the Sri Lankan pie, India is trying to pull out a plum in Afghanistan too. It wants Afghanistan to go on being ruled by the Soviet Union's client, Mr Najibullah, rather than to become an Islamic state under the influence of Pakistan.

On May 3rd the Indian foreign minister, Mr K.P.S. Menon, called on Pakistan's President Zia ul Haq in Islamabad. The visitor was told, politely but firmly, that India had no role to play in resolving Afghanistan's civil war. (For good measure, Pakistan took the opportunity to deny that it was shipping arms to Sikh separatists in Punjab.) The chilly message did nothing to lessen the warmth accorded to Mr Najibullah when he visited Delhi next day.

India's policy towards Afghanistan was deliberately ambiguous in Indira Gandhi's day. She declined to condemn the Soviet invasion in public, but talked tough to the Russians in private. Since her son Rajiv came to power India and Afghanistan have moved much closer together. India enthusiastically endorsed Mr Najibullah's programme of "national reconciliation", and

put its weight behind his attempts to win international recognition. It tried, and failed, to get Afghanistan accepted into the fledgling South Asian Association for Regional Co-operation. India is the only



Najibullah declamatory

non-communist country to have received Mr Najibullah. The Afghan leader's visit to Delhi this week is his second in five months.

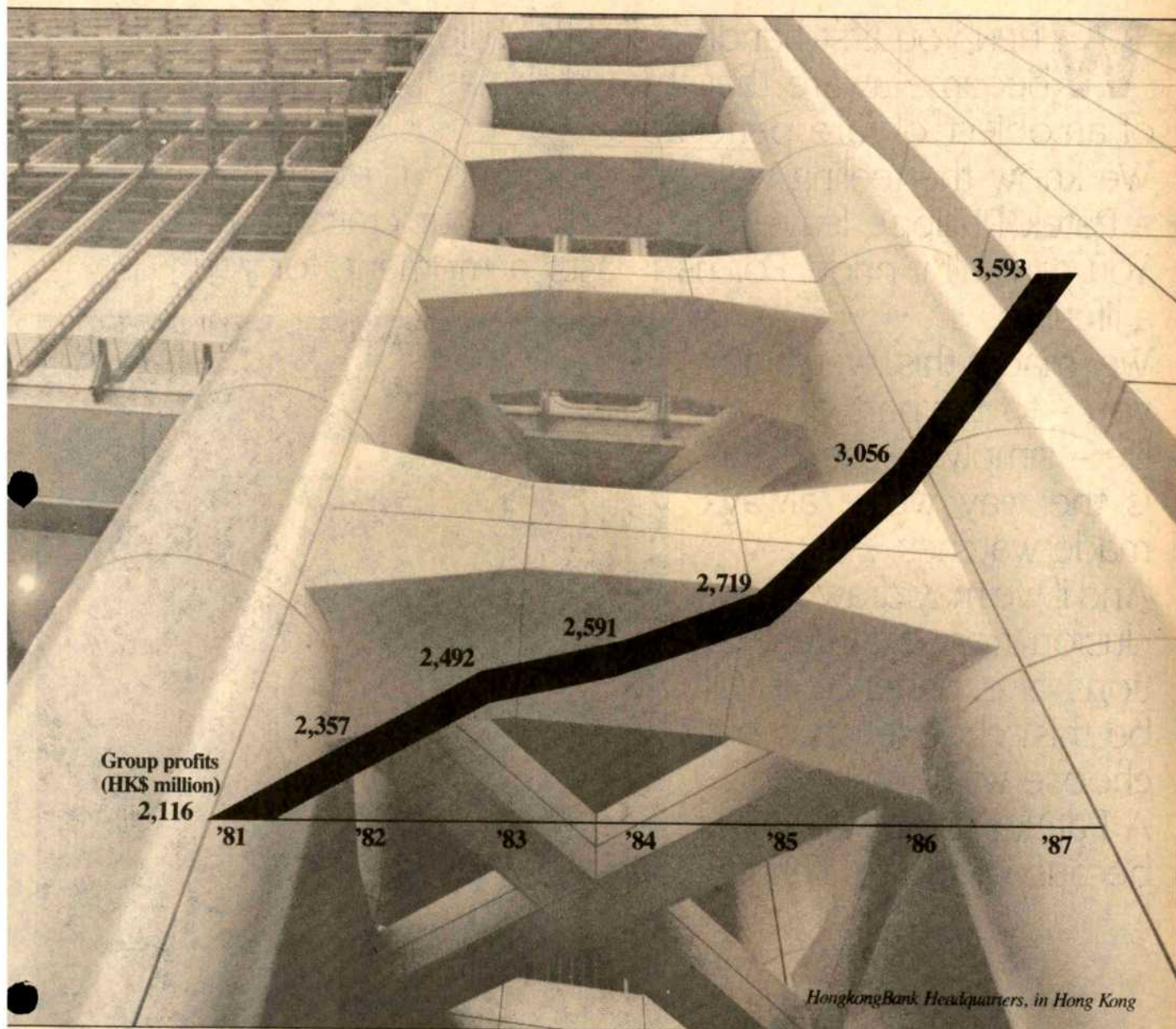
The thought that a Pakistan-influ-

enced government might succeed Mr Najibullah's when the Russians leave Afghanistan sends shivers down Indian spines. India has maintained close ties with successive Afghan regimes since 1947, and has received sympathy if not active support from them in its disputes with Pakistan.

The Indian embassy used to be one of the largest and most influential in Kabul. It now has a limited hand to play. The Afghan nationalists with whom it enjoyed good links in the past have lost power and been scattered since the Soviet invasion. The fundamentalist guerrilla groups, created and supported by Pakistan, are staunchly anti-India. The guerrilla supremo, Mr Gulbuddin Heckmatyar, who has been on Pakistan's payroll since 1974, has even suggested a confederation between Pakistan and Afghanistan.

Several months ago, as the implications of a Soviet withdrawal sank in, an Indian envoy went to Rome to see Afghanistan's former King Zahir Shah. Since that visit, and perhaps because of it, Pakistan has ruled out his return to Afghanistan as a figurehead of national unity. Pakistan, deeply suspicious of Indian intentions, will continue to resist India's moves to manipulate the Afghan outcome. That is unlikely to keep India from trying.

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- total dividends per share up 5.6% to HK\$0.38 (US\$0.05)

- assets increased by 17.1% to HK\$837 billion (US\$107.8 billion).

During the year, the group raised its shareholding in Marine Midland Banks, Inc., in the USA, to 100% and acquired a 14.9% stake in Midland Bank plc, in the United Kingdom.

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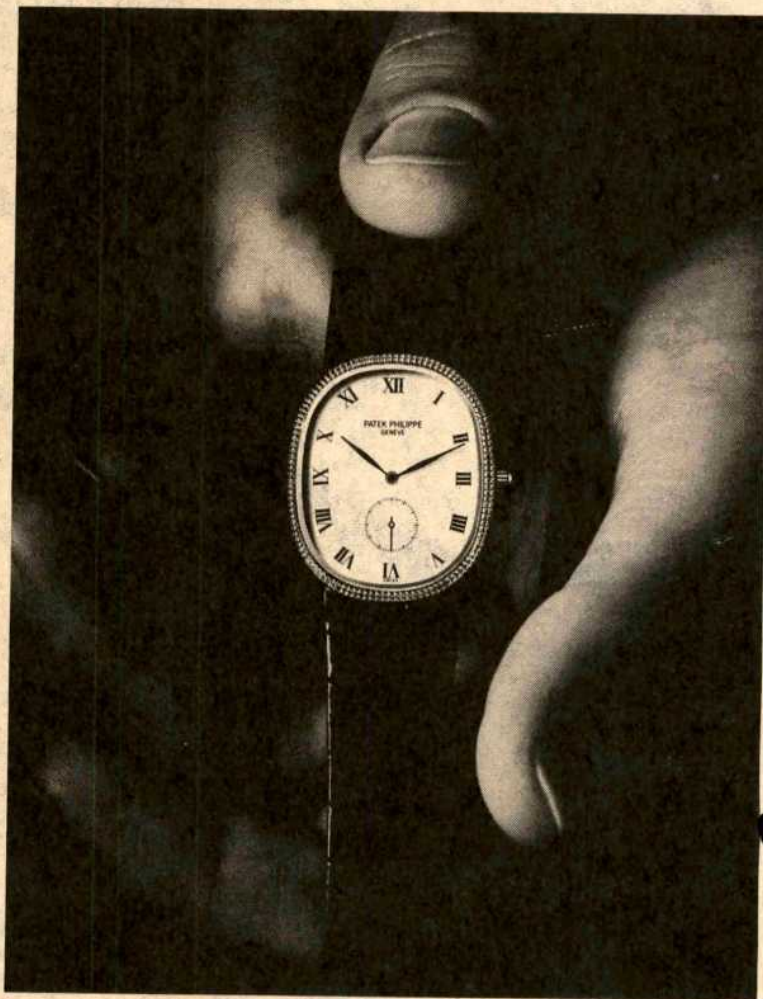
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volved system.

A Sinhalese extremist group, the People's Liberation Front, sees the new councils—even ones in Sinhalese areas—as part of a plot. The Front's declared penalty for anyone backing them is death. When election day came, however, its gangs managed only to throw two bombs, which did no great harm, shoot a policeman and set fire to a railway station. The Front still has punch, however, as it showed on May 4th by murdering four more people.

The biggest loser was the Sri Lanka Freedom party, the main opposition group. It denounced the provincial elections and made the mistake of boycotting them. Their success has left both the ruling party and the alternative Sinhalese opposition group, the United Socialist Alliance, which did field candidates, looking statesmanlike. The Freedom party is now claiming that it would have won in some, perhaps in all four, of the provinces if it had joined in. But it did not.

Mr Jayewardene's party now controls four of the seven predominantly Sinhalese provinces, and will probably win the other three when they go to the polls early in June.

In the remaining two provinces, the Northern and Eastern ones, where the trouble started, the Sri Lanka Freedom party, which (unlike the Socialist Alliance) attacked the India-Sri Lanka deal, has no role to play. Who does is far from clear. The Tamil Tiger guerrillas, although seriously hurt by the Indian army's intervention, still have the destructive power to blow up one bus, ambush another and plant a bomb, all during the past week. They will still try to apply a veto of violence to the elections in the north and east. Whether the Indians can get them to turn to peaceful politics remains to be seen. The present sticking-point in the talks, a familiar one, is over how many arms the guerrillas should surrender, and when.

There is no sign yet that any party would be prepared to put up candidates in the north and east. Time is pressing. Those elections have to be held by August at the latest, so that a presidential election can be held by the end of the year—and a parliamentary election, too, if President Jayewardene has his way. It will be touch and go.

Thailand

Well, it's better than a coup

FROM OUR SPECIAL CORRESPONDENT IN BANGKOK

IT USED to be that when Thai politics fell into disarray, the tanks rolled in to fix it. When it happened last week the prime minister, General Prem Tinsulanonda, just called an election for July 24th, and went to play golf.

He was joined on the course by sundry politicians and military men, among them the army's commander-in-chief, General Chavalit Yongchaiyudh. From this it was deduced that Mr Prem still has plenty of support, and that the army is still behind him. He has been prime minister for eight years and takes credit for Thailand's relative calm during that period, and for the fact that its economy is in good shape. He hopes to get the support of the four parties which formed the ruling coalition after the 1986 election.

Opposing him, however, is a group of 11 parties, some of which would prefer General Chavalit to be the next prime minister. The general has some popular support, but conservatives grumble suspiciously about him and he does not seem to have the clear approval of the king. That, in Thailand, is still essential for anyone seeking the top job. The general has complained of corruption in political life and has called for "a quiet revolution", whatever that means. The general tried to hand in his resignation as army chief after the election was announced, but Mr Prem refused it, thereby keeping his opponent out of the race for now. Another possible candidate is Mr Kukrit Pramoj, an elderly former prime minister and a vociferous critic of Mr Prem.

If Mr Prem holds on to the prime ministership, he may find the new parliament as rumbustious as the old. One of the main coalition members, the Democrat party, has split. A no-confidence debate due on May 9th had been expected to throw up a lot of mud: alleged corruption by ministers; the army's poor performance in the border war with Laos; even allegations about the sexual tastes of the prime minister. Mr Prem called the election rather than face the debate. Yet the new parliament could revive the no-confidence issue.

One quarrelsome issue unlikely to go away is copyright. Thailand is a paradise for counterfeiters (whose activities bring in a lot of money). The departing government, under American pressure, had introduced a bill to prevent the pirating of computer software. The bill will be just as contentious when it is reintroduced after the election.

The way for any Thai prime minister to gain a smooth passage for himself is a bargaining process which guarantees good jobs to the right people and favours to political parties. It is already under way. The main feature of the run-up to July 24th will probably be high-level negotiations for allegiances, and thereby for power. The election itself is likely to be costly in other ways. Buying a single vote can cost \$10. Mr Chamlong Srimuang, the well-regarded governor of Bangkok (he tidied up the streets), has started a political party whose candidates are forbidden to buy votes or accept high political office. His party is a small one.

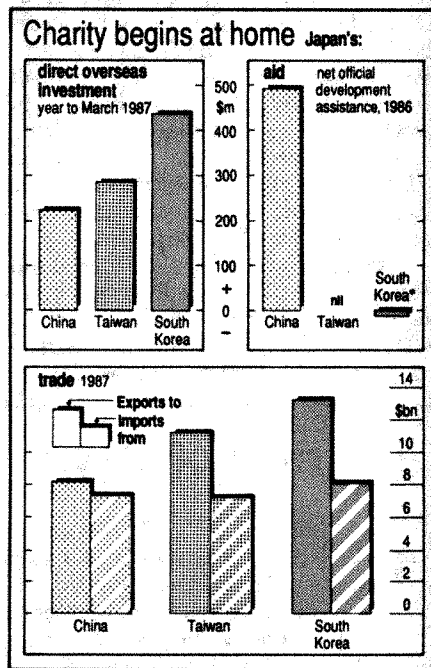
Japan and China

The war that will not die

FROM OUR TOKYO CORRESPONDENT

JAPAN'S prime minister, Mr Noboru Takeshita, was in London this week, hoping to convince Mrs Thatcher that he is a man to be reckoned with. It was an important call for Mr Takeshita, who is having trouble measuring up to the foreign-policy skills of his predecessor, Mr Yasuhiro Nakasone. His efforts to be a statesman, however, may get nowhere if he cannot convince his colleagues that tact is called for—especially in Japan's own back yard. No sooner does Japan shower Asia with some extra trade, aid or investment than some cabinet member blights the effort by another show of the Japanese nationalism that still makes other Asians shudder.

The Japanese foreign minister, Mr Sosuke Uno, arrived in Beijing on May 3rd bearing a handsome gift: aid worth ¥192 bil-



lion (\$1.5 billion), part of which will go towards building Beijing's new underground railway. In return he got a wiggling from his Chinese counterpart, Mr Qian Qichen, about the statement made late last month by a Japanese cabinet minister, the 75-year-old Mr Seisuke Okuno, that Japan was not an aggressor in the second world war. His country, said Mr Okuno, was merely defending itself against "the white race that had turned Asia into a colony"—which would have come as news to Chinese at the time.

Only 18 months ago Mr Nakasone had to sack his education minister, the 68-year-

old Mr Masayuki Fujio, for expressing similar sentiments. Mr Takeshita had hoped that the Okuno affair would blow over. Before Mr Okuno's gaffe, Mr Deng Xiaoping had told Mr Masayoshi Ito, a Japanese politician close to Mr Takeshita, that China realised ultra-nationalist views in Japan were confined to dodderers on the right of the ruling Liberal Democratic party (though they were no less regrettable for that). Mr Qian's complaint to Mr Uno suggests that China is ready neither to forgive nor forget.

China's line that Japan still has a debt to pay for the war is a useful spur to Japanese aid and investment, but both countries have an interest in keeping the issue in proportion. China needs Japanese help with modernising its economy. It also wants Japan to act as a bridge to South Korea (with which China still has no diplomatic relations): South Korean factories and technology may be more suitable than Japan's for a country at China's level of development.

Japan likes playing the regional statesman. It needs the support of a stable and growing China to succeed in the role, and thinks Mr Deng's economic reforms offer the best chance of that. It is also anxious that Mr Takeshita's visit to China in August should be a success. The Japanese government is cajoling its businessmen to forget about the hardships of doing business in China and increase their investment there. They are showing signs of responding, mostly because rising currencies and labour costs are making South Korea and Taiwan too expensive for offshore production.

Trade and investment aside, there is still plenty of scope for jockeying between Japan and China. The Chinese see Japan, with its tight links to the United States, as a restraining force on the Russians. But the Chinese



We're just here to protect you from the white race, and give me that soup

are nervous about the softer approach the Japanese have been taking in recent weeks towards the Soviet Union (though the softening was so subtle that the Russians probably didn't notice). Relations between Japan and Russia are unlikely to improve fast—remember the four northern Japanese islands that the Soviet Union occupies—but any sign of a thaw would worry China.

So would any sign of a breakthrough between China and Russia worry Japan. This week a Japanese newspaper revived an old rumour that the Soviet Union and China

may be moving towards some sort of non-aggression treaty. That is unlikely to happen soon, but one purpose of Mr Uno's visit was to find out if China's view of the Soviet Union is being influenced by the Afghanistan withdrawal. He was also looking for any hint of a shift in Chinese policy on the Koreans and on Kampuchea. Not that Japan, whose diplomacy is still denominated almost entirely in yen, would have any idea what to do if China were to make a big change. But at least it is asking some questions.

The rites of May

FROM OUR TOKYO CORRESPONDENT

IN AN annual ritual on Japan's Constitution Day holiday, May 3rd, bigwigs in the ruling Liberal Democratic party call for a rewriting of the constitution that General Douglas MacArthur, as head of the postwar American occupation, bestowed on their country in 1946. Some of the party's members (among them Mr Yasuhiro Nakasone) see it as a lingering symbol of Japan's defeat in the war that ended in 1945. They say they want a Japanese-written constitution instead of an American-written one. They do not make it clear what this would mean in practical terms.

This year, 243 of the 445 Liberal Democratic members of parliament turned up at a rally led by Mr Mutsuo Kimura, a former minister now in the upper house.

Since 1983 Mr Kimura has campaigned for three constitutional changes. He proposes that (in article 1) the emperor should be named as head of state, not merely as the "symbol" of the state; that (in article 9, which renounces war) it should be explicitly stated that Japan can maintain limited military forces for its defence; and that (in article 89) state aid for private education should be permitted. This year Mr Kimura added a fourth proposal. He wants article 29, which asserts the inviolable right of private property, amended to make it easier for the government to take land by compulsory purchase, for such things as building roads.

The article 29 curlicue apart, Mr Kimura's list represents one of the most powerful issues in Japanese politics. The

constitution has become a symbol of a particular kind of Japan: the non-nationalist, money-making one that has thrived since the end of the second world war. Changing it would be a radical act. Since the ruling party has never come close to having the two-thirds majority in parliament that is required for amending the constitution, the debate remains a theoretical one. But it is no less bitter for that.

When Mr Noboru Takeshita took office as prime minister last November, he said that constitutional revision was "not on his political agenda". Although his predecessor, Mr Nakasone, had something of an obsession about it, even he acknowledged that it was too delicate a subject to tackle. Yet it is now believed in Tokyo that the Kimura group has Mr Takeshita's quiet blessing. The course of the debate may tell a good deal about the role in the world that the new Japan will try to make for itself.

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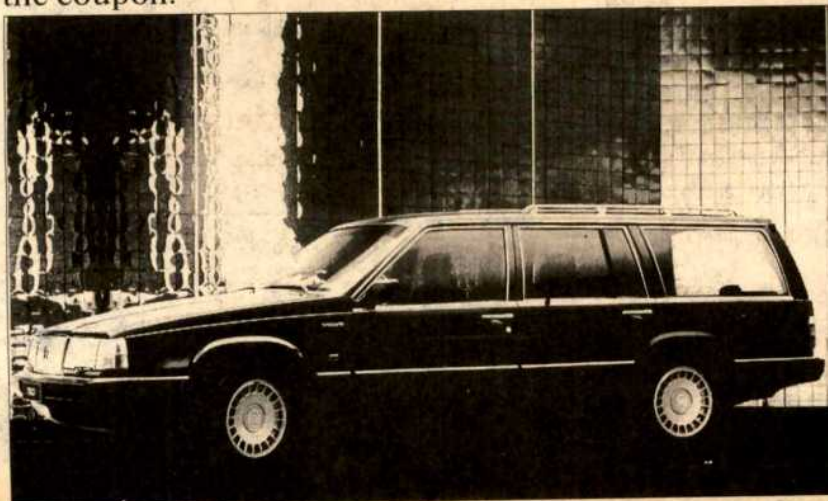
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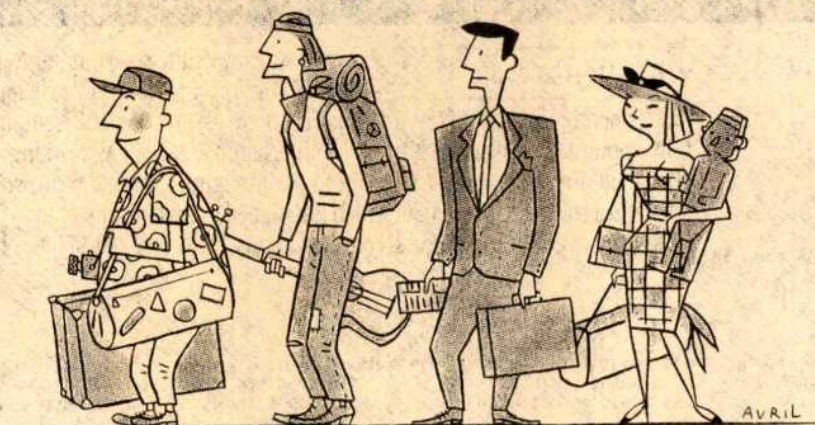


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AMERICAN SURVEY

A man, a plan, a cabal . . . Panama

WASHINGTON, DC



Hell, no. Noriega won't go

WASHINGTON is a fickle city. In February, when General Manuel Antonio Noriega was indicted in Miami for drug dealing and the White House began its vigorous attempts to oust him from power in Panama, few voices were critical of the administration. Those who did criticise were mostly wanting harsher, military measures. Economic pressure, agreed the rest, was the right way to force General Noriega out. Now that the economic pressure has failed to shift him, and seems only to be turning friendly Panamanians and other Latins into Yanqui-haters, Washington is suddenly filled with critics of the policy.

Economic pressure, they say, could never have worked. It was bound to hurt ordinary Panamanians, while doing little to change the mind of an unscrupulous and allegedly drug-enriched dictator. The indictment of General Noriega was a tactical error. Recognising Mr Eric Delvalle as president (a job he got courtesy of the general's ballot-box stuffers) and encouraging him to try to sack General Noriega were both foolish. And the administration ig-

nored the best vehicle for its policy: a concerted attempt by other Latin American countries to persuade General Noriega to leave. Now, worst of all, the administration, in order to save face, seems to be abandoning the opposition politicians in Panama by negotiating, through Mr Michael Kozak of the State Department, to allow the general to stay in the country after he steps down from the army.

Such recriminations are, with hindsight, understandable. The truth is that the administration stumbled into its diplomatic debacle partly to distract attention from its defeat on contra aid, and partly by mistake. The indictment of General Noriega, by a grand jury in Miami, was not, as much of Latin America clearly thinks, part of the strategy. It was done over the protests of many American diplomats, who saw how firmly the risk of extradition and trial would cement the general to his throne. The federal prosecutor in Miami simply went ahead with the charges. He probably felt that if he did not act when he did, he would be preempted by hearings in the Senate, which a

week later revealed the extent of General Noriega's alleged involvement in the drug trade. Any indictment would then seem to have been forced by Congress.

Once the indictment was fact, the administration had no choice but to try to oust the general by more public means than it had hitherto used. But it was a tactical mistake to embrace Mr Delvalle, once the president had suggested (if it was his suggestion) that he might dismiss the troublesome general. The Americans should have tried to dissuade him from the attempt, which failed so promptly and made the erstwhile puppet the unlikely new champion of democracy. That, in turn, persuaded the real opposition in Panama that Uncle Sam would do its dirty work while it sat back and watched. It therefore failed to deliver the popular discontent with the regime that was supposed to follow the economic sanctions.

A country whose currency is dollars and whose speciality is banking is peculiarly vulnerable to economic sanctions from the United States. A group of senators, ranging from Mr John Kerry, a Democrat from Massachusetts, on the left to Mr Alfonse D'Amato, a Republican from New York, on the right, urged the administration to use tough economic sanctions. Almost alone, the Rev Jesse Jackson foresaw the failure of the policy and the damage it would do to Panama. It is wrong, he said, to set the whole forest on fire to smoke out one villain. He had nothing better to offer than write to General Noriega and beg him to step down—for which he was rightly ridiculed. Yet that is what the administration is now reduced to.

What else could the administration have done? From the right wing comes the complaint that the sanctions might have worked better had they been more promptly applied. Yet they did work. They worked only too well, reducing industrial production by 40%. But that did not prevent General Noriega from paying his army.

From the left comes a different complaint, and one with more force. The United States might have achieved its ends in Panama had it used its allies in the region. Three former presidents, of Colombia, Costa Rica and Venezuela, began last November to develop a plan under which General Noriega would agree to relax his grip on power and allow democratisation to proceed, in exchange for possible retirement for him in Spain after his 25 years of military service ends in May this year. Mr Carlos Andres Perez, the Venezuelan in the group, told the *New York Times* on May 2nd that they got the agreement of General Noriega just two

AMERICAN SURVEY

days before Mr Delvalle's bungled attempt to sack him on February 25th.

Mr Perez thus lent support to those in Washington calling for a Latin American solution. They would like the United States to support the enterprise of the three former presidents, saying to them: once we have agreed on the aims, you write the script, describing exactly how General Noriega gives up power, sanitises Panama's armed forces and leaves behind a democracy. Diplomatic isolation in Latin America, they imply, would be more menacing to the general than was economic strangulation.

There is not much prospect of the Reagan administration adopting such a policy. It distrusts multilateralism, and usually prefers writing the script itself. So it is left in the position of negotiating directly with General Noriega from a position of declining strength, appearing to sell out the opposition in Panama by giving in to the general's demand to stay there after his eventual retirement, and encouraging those on the far right in Washington who are alarmed at the thought of the Panamanian army gaining control over the canal zone in 2000.

Drugs

Four shots, no injuries

WASHINGTON, DC

IT WAS in 1986 that President and Mrs Reagan went on television together to call for a "national crusade" against drugs. As that year's congressional elections approached, competition for the glory of producing the most far-reaching anti-drugs legislation became frantic, and in October a voluminous bill was enacted. Among its many provisions were rules to cajole foreign countries into helping to suppress the narcotics trade. One rule said that from a list of producing and transit countries the president was to certify to Congress those that "fully" co-operated with his efforts. Those that he could not certify were to be punished by losing their foreign aid, or some of it, and by the use of the weighty United States votes in the international institutions to deny them development loans. Congress was to have power to reject the president's certification, and so trigger the penalties, if it chose. Adopted in end-of-session haste, the rules have lived to bedevil United States diplomacy in Latin America.

The Senate set off an uproar on April 14th by voting to disapprove the president's certification of Mexico as co-operating "fully" in the interception effort. Mexico is an abundant producer of marijuana and a staging area for cocaine, and, although the truth seems to be that its government is do-

ing its best in the war against drugs, its best is not enough. To take effect, however, the Senate's rejection must be agreed to by the House of Representatives too. Mr Larry Smith, the chairman of a House task-force on drugs, is keen to get the House to join the Senate, after which the only way in which Mexico would get aid would be for the president to use his power to cite the national interest and certify it. He might. The only aid Mexico gets is \$14m—to fight drugs.

The decision has not yet gone to the full House, and may not do so. The House Foreign Affairs Committee debated the Mexico resolution for most of April 27th, together with four other resolutions to "decertify" the Bahamas, Peru, Bolivia and Paraguay. The Senate had refused to act against the Bahamas and had not considered action against the other three. Nobody even mentioned Colombia, it being generally assumed that the Colombian government is powerless to do anything against drug traders. The accused countries have been taking the threat seriously, bombarding their congressional friends with proof of their genuine, if ineffectual, efforts against drugs. From La Paz there even came word of a bill introduced in the Bolivian congress to make the cultivation of the coca plant illegal, a measure sure to be unenforceable.

Under the seasoned chairmanship of Mr Dante Fascell, the Foreign Affairs Committee was delicate in its decisions. Politics seemed to require some rebuke for the Latin miscreants, but policy required that it not do any harm. The committee has declined to make a decision about Mexico, thus contriving that the Senate's action comes to nothing. It has taken no decision about the



Mexico does its best

Bahamas, either. It has recommended House to disapprove the certification of Bolivia, Peru and Paraguay, but this act too, will come to nothing since the Senate not likely to duplicate it. Four warning shots have been fired. Nobody has been hit.

Immigration

Day of judgment

WASHINGTON, DC

THE immigration offices stayed open Wednesday night to catch the last procrastinator. Then the curtain fell on one-year amnesty for immigrants who have lived in the United States, illegally but continuously, since January 1 1982. Even in the great last-minute surge, only about three-quarters of those who might have qualified for legalisation under the 1986 migration act had applied for it: some 500,000 outlaws, and perhaps more, stand in the shadows. It was thought that between 1.8m and 2.6m people were eligible for amnesty; about 1.5m people applied. It excludes seasonal farm workers who, in reference to California's agro-businesses, are a separate category, and have another months in which to apply.

The amnesty was an outstanding success, says the commissioner of the Immigration and Naturalisation Service (INS). Credit demerit. Everything was falling into place at the end of the programme, they say, but then it was too late for many. They point to the inadequacy of the campaign to publicise and explain the amnesty, the confusion of complex and shifting regulations (which were made more liberal as time went on), the pervading fear of many illegal aliens that if they stepped into line, they could be speeding towards deportation. In fact nearly all the people who have so far asked for amnesty have been given it, and the INS promised not to use the information it collects to sweep up those who are rejected.

The level of response differed between regions and races. It was strongest in California (home to roughly half of American illegal immigrants) and in the south-west, particularly Texas. More than 70% of applicants have been Mexicans, who probably account for 50-60% of the eligible immigrants. The north-east, including New York with its large Caribbean and Asian population, responded sluggishly.

Westerners were much better than easterners at getting the word out. Individual INS officers were wonderfully zealous, coaxing illegal aliens out into the light. They were helped by various groups, notably the Roman Catholic church in Los Angeles. And they found it easier to reach Spanish speakers than more fragmented groups.

People who had been busted by the



Documented at last

had to learn to trust it. People who had tried assiduously to hide all trace of their existence had suddenly to produce a paper trail to prove a six-year residence. The INS, on the whole, did its best to help them, accepting a flexible variety of documents—pay slips, school records, postmarked letters, affidavits—as proof of residence. The rules, which allowed only short absences from the United States since 1982, favoured Mexicans and Central Americans (Salvadorans came a distant second among applicants), who could slip home across the frontier, leaving no record of long absences. Dates could be fudged. But people from farther afield, who had arrived by sea or air, had entry and departure dates indelibly marked in their passports. All immigrants were afraid at their families could be split, some members accepted and some not. That was a particularly worrying prospect for those who thought they faced deportation to a distant country.

Even successful applicants have more obstacles to overcome. Within the next 18 months they have to pass a test in English and on the American constitution in order to move on to the next, more permanent, stage on the road to citizenship. And the INS's smiling face reverted, on May 5th, to its more familiar scowl. Its powers have been extended by the immigration act. In the past illegal workers who were caught were in trouble, but their employers were not. Since last September, however, employers are liable to fines or prison sentences if they knowingly employ an undocumented worker. Reports from California tell of a thriving business in forged documents to help employers to remain blissfully unknowing.

Primary elections

Not what they were

TOLEDO



The candidates went through the motions of campaigning for this week's three primaries, but neither their hearts nor those of the voters were in it. For the candidates, the carnival is almost over. The voters of Ohio, Indiana and the District of Columbia could only reminisce about the days when their votes counted: when Bobby Kennedy won Indiana in 1968, when Mr Gary Hart upset Mr Walter Mondale in Ohio in 1984.

This year all three contests were foregone conclusions, though there were prizes for each of the candidates. Mr George Bush won the uncontested Republican races, of course. Mr Michael Dukakis won the Democratic contests in both states, taking 69% of the vote in Indiana and 63% in Ohio. And the Rev Jesse Jackson won in the country's capital by a huge margin, taking four out of every five votes. Of the three, the only primary to receive much attention from the candidates was Ohio. Indiana is too reliably Republican for a Democrat with no close opponent to waste his time there. The District of Columbia, where blacks outnumber whites by more than two to one, offered few hopes for Mr Dukakis.

Ohio, though, is a big state with big industries and big cities. It usually chooses the winner in presidential elections, so a good dry run, which helps to build support for the general election, is worth striving for. The strategists already thinking about November consider Ohio a state the Democrats must win. They have even been suggesting that Mr Dukakis should pick the dull but heroic Senator John Glenn as a running-mate to ensure victory here.

Ohio is the heart of the smokestack country, with some of Pennsylvania's steel and some of Michigan's cars. From the old Republican stronghold of Cincinnati in the south-west to ethnic, Democratic Cleveland in the north-east, it is a blue-collar state that produces things, not services. Its unemployment has been high but is falling. Its workers are uneasy: uneasy at how often they now have to change jobs, uneasy at the implications of automation. Those in work are doing well. Those not in work are having to move and retrain and, sometimes, suffer.

The campaign in Ohio was not about foreign policy or social issues. It was about industry, jobs and trade. Mr Jackson's anger at insensitive bosses, greedy corporate raiders and protectionist foreigners fell on fertile ground. Noticing this, Mr Dukakis borrowed a little of it, attacking Wall Street and

calling for an increase in the minimum wage. But mainly he stuck to his perennial themes: an industrial policy that brings "good jobs at good wages", affordable housing, health care for all, retraining programmes to get people off welfare. He goes down well, partly because the press has led his audiences to expect such dullness that they are pleasantly surprised. But also because voters give him the credit for the technology-driven prosperity of his own state, however much the academics may try to deny him it. Asked why they supported him, many of the people in a crowd outside a car plant in Toledo replied: because he can do for Ohio what he has done for Massachusetts. Many of them used to vote for Mr Reagan.

Mr Jackson did not give the governor a free ride. He outspent Mr Dukakis on television, and even for the first time put out a commercial directly attacking his opponent. Calling him a Teflon candidate, Mr Jackson accused him of failing to give details of his programme. Mr Jackson is preparing for an assault on California on June 7th, where his best hope is to portray Mr Dukakis as a right-winger. For Mr Dukakis, with his eyes sliding right towards the undecided voters in the general election, the charge is welcome.

The allies

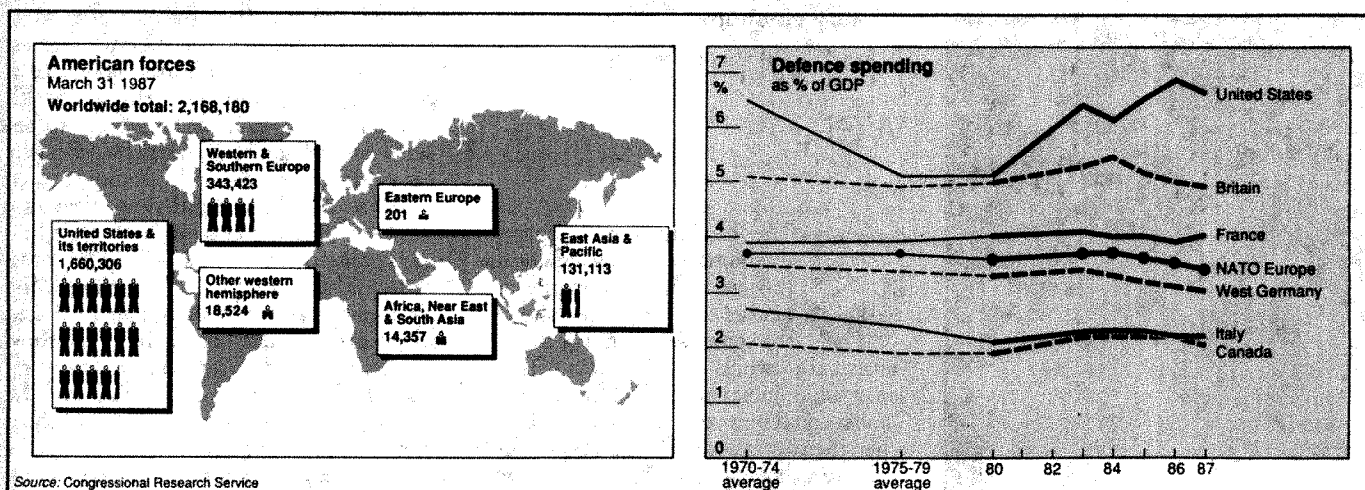
Time to share the burden

WASHINGTON, DC

AMERICANS spend a lot more on defence than do their allies and, every now and then, they feel sore about it. Such a time is now. The budget deficit is obliging the country to retrench. The trade deficit is seen as evidence that America's allies, secure under American protection, have sneakily been strengthening their industries at America's expense. The November elections contribute a shrill political variation to the low hum of economic discontent.

In all, about 20 pieces of legislation aimed at getting the allies to pull their weight in defence are, or have been, before the House of Representatives this session. They include amendments that propose cutting American troop levels in Europe and Asia unless the allies spend more on defence, bills imposing surcharges on imports to offset the disparity in defence spending, and resolutions calling on the president to persuade the allies to be more helpful both at home and beyond. As with trade, American anger focuses more on Japan than on Europe. Europe, however, is not left out.

None of these measures, making their way through committees, has much chance of becoming law, at least not this year, with



this administration and this Congress. A couple of unfriendly amendments to the defence appropriations bill have just been thrown out. And the administration wants to dispel the notion that the allies are about to be bullied; it has dispatched Mr William Taft, the deputy defence secretary, on a tour of European capitals, bearing an unthreatening message. The allies, the administration feels, have to be treated sensitively these days after the upsets of superpower treaty-making: the carrot (joint research projects) has replaced the stick (the threat of American troop reductions).

Yet this bout of American impatience, like earlier ones, reflects a strong dissatisfaction that will not miraculously vanish. This time many of the Americans who are arguing for a change in burden-sharing are not calculating in straight cash-register terms. They are searching for a new approach, far removed from simple accountancy. The debate, they say, should be as much about the sharing of responsibilities as the sharing of financial costs.

Fighting over numbers, year after year, has got America and its allies nowhere. America spends more than the others, but what does it spend it on? The joint expense-sheet and the methodology behind the calculations are acrimoniously and inconclusively disputed: no formula is accepted by both sides. Contributions, say the defensive allies (supported by a few Americans), should be measured by the quality of the output as well as the size of the input, plus countless non-statistical factors, such as the wear and tear on West Germany attributable to its role as host to so many of NATO's forces.

The Reagan administration, partly accepting these arguments, discourages the numbers game. Representative Pat Schroeder, a Democrat from Colorado who chairs an Armed Services Committee task-force on burden-sharing, accuses the Defence Department of gilding the European contribution to make it shine more brightly. The administration, plucking an idea from long ago

(it was articulated by John Kennedy), speaks of Europe as the second pillar holding up the NATO alliance. The pillar's political strength should be fortified to stand the test of crises both in the members' region (Denmark, the latest small crisis) and outside it (the Gulf, the continuing big crisis).

The administration remains a bit ambivalent on the revitalised Western European Union. But, at least in theory, the Europeans have earned credit points for their efforts to co-ordinate their military actions. And though most members of the American public still believe that their own warships alone are responsible for patrolling the Gulf, the few who know better are pleased by what the British, French, Italians, Dutch and Belgians are doing.

Many congressmen, however, would still like to see the colour of allied money. A report on "NATO in the 1990s" by a committee of the North Atlantic Assembly, to be presented to Mr Reagan and the other heads of government later this month, discusses these immediate financial concerns, as well as pursuing the search for a more responsible European role. The committee, which was chaired by Senator William Roth (Senator Sam Nunn was also a member), recommended among other things that:

- NATO members should consider the provision of bases as an integral part of their contribution and should not seek financial compensation for them from the United States. On the other hand, the richer North European governments might well consider helping their poorer (and base-providing) southern neighbours, Greece, Turkey and Portugal.

- European members of NATO should get together regularly to identify global and regional threats, and agree how to respond, collectively and individually.

- A European division might be formed, on the lines of the planned Franco-German brigade.

- Task specialisation should be encouraged. In particular, jobs should be assigned to the smaller European countries.

The committee touched gingerly on shared leadership, even looking down the road to a time when a non-American might command the allied forces.

Another introspective look at NA ("Comprehensive Security and Western Prosperity", written by Mr Leonard Sullivan, a former assistant secretary of defence, and based on the deliberations of an Atlantic Council working group) is more provocative. Mr Sullivan argues that Europe and Japan must accept a less altruistic America; America must accept stronger regional blocks across the Atlantic and Pacific. And since the threat to western security is far more diffuse than it once was, the West's response should be broadened to match it.

The main danger these days, argues Mr Sullivan, is not a direct Soviet attack. Allied contributions to collective security should be measured on a far wider scale, taking in money spent on such things as foreign aid, the fight against drugs and the resettlement of refugees. Leadership, he says, is a burden to be shared: it should not go to the biggest or the richest or the one most willing to pick up the bill, but to the country that has the expert knowledge, the historical commitment and the strongest national interest in the area concerned.

Such ideas as these are increasingly voiced by thoughtful Americans as they ponder the consequences of America's diminishing pre-eminence on the world stage. In the meantime, however, there are bills to be paid.

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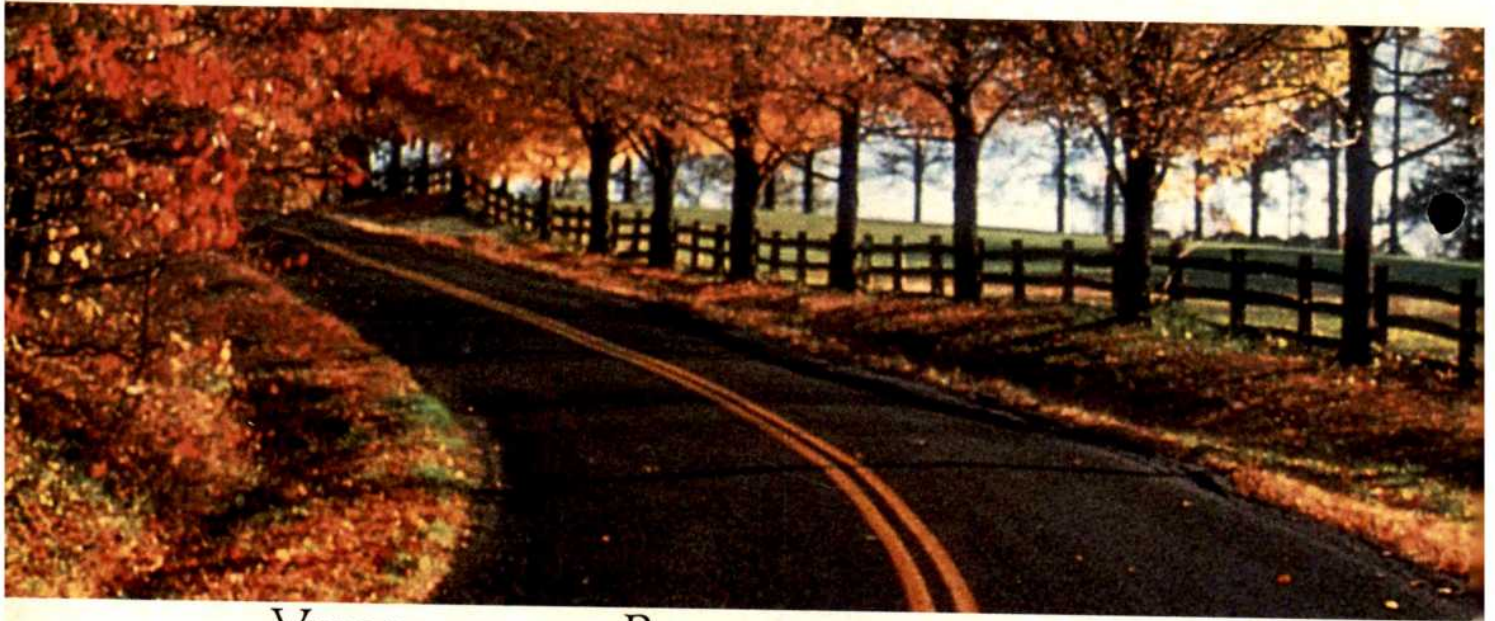
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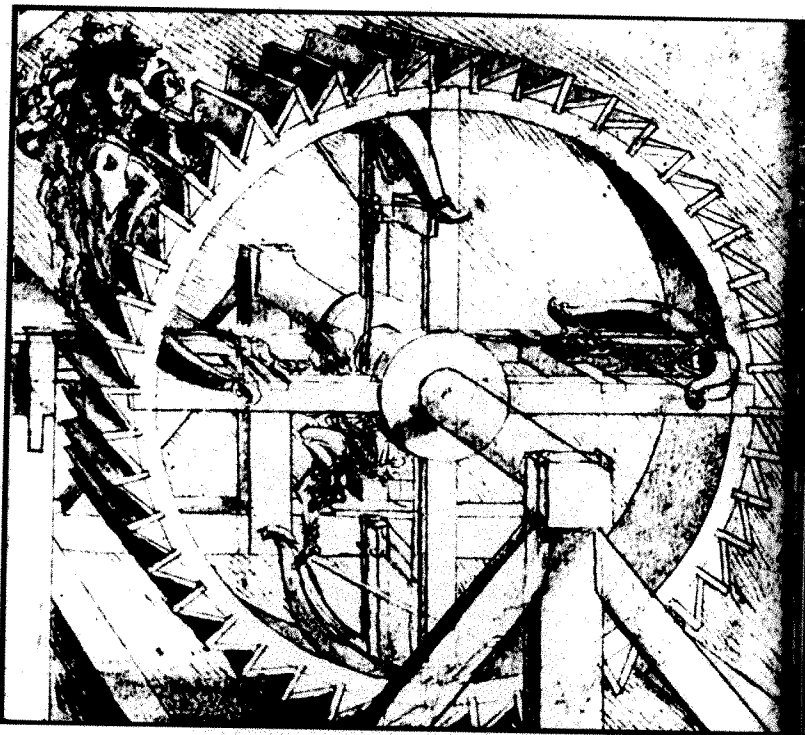
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the sport free of labour troubles for at least six years. The NBA gets stability; the players get a degree of freedom over where they work. Others in professional sports, notably the owners and players of the National Football League, can only look on with envy.

Just a few years ago the basketball league was struggling. But the 1987-88 season was a good one. More people attended NBA games than ever before—some 12.7m, a 4.9% increase over the previous season. That meant an average of more than 13,400 spectators at every game played between October and April. Fifteen of the 23 teams had increased attendance (three others had no change) and three teams (in Boston, Portland and Sacramento) had a full house for every home game. Not bad for 41 home games with an average ticket price of \$13.50.

Popular players, ticket promotions, teams moving to more hospitable cities and fewer televised games have given the NBA a 31% increase in attendance in five years. The league is celebrating by expanding: the Miami Heat and the Charlotte Hornets will play in the 1988-89 season, the Minnesota Timberwolves and the Orlando Magic will make their debuts in 1989-90.

It is the agreement with the players' union, announced on April 26th, that may be the best news for players and owners alike. Ending the bickering (and litigating) that has been going on for more than a year since the last contract expired, it deals with the basic division found in most professional team sports: the players' desire to sell their skills in a free market (playing for the highest bidder), and the owners' desire to control the movement of players (keeping salary costs down).

One change concerns the NBA's annual

draft of college players, in which teams pick the best players and thus gain sole right to give them a contract. Under the agreement, teams will be able to pick only two, rather than seven players in the draft. This means that only the most exceptional, and so the highest paid, players will be picked. The rest will be able to choose where they play, presuming they are wanted. Once they have a player under contract, teams will be able to retain his services after the contract expires by matching other bids. This they can do now. However, this "right of first refusal", which the players believe inhibits their ability to play where they wish, will now apply only to the first contract. After a second contract expires, the player is on his own. Partial freedom.

The owners, too, got a lot of what they wanted. The current salary cap imposed on all teams—opposed by the players during the current negotiations—is kept. It allows teams to pay individual players as much as they want to, but sets a maximum that any team may spend on salaries in total. The players have no reason to be too sorry for themselves. One estimate is that by 1993 the average salary for an NBA player could have doubled to \$1m a year.

By contrast, the National Football League is still feeling the effects of the bitter four-week strike called by its players last autumn over much the same issue. The football players are the least free to move among teams of professional players in major-league American sports. Few players ever move from one team to another unless they are traded or have been discarded by their previous team. The league rules require teams to pay high compensation if they hire a player whose contract has expired with another team but who is still wanted by that team. If the original team matches the salary offer of the new team, the player stays where he is. This makes most good football players highly paid slaves.

The NFL owners were ruthless when the players struck, almost immediately fielding "replacement" teams and continuing through the season as if nothing had happened. The players returned after a month, without a new agreement and with nothing to show for their strike. Nothing until now. On April 28th the National Labour Relations Board ruled that a legal impasse existed between the NFL and the players' union. This allows the union to move on to the next step and seek a court injunction to prohibit the NFL teams from retaining the rights of players whose contracts have expired. To the chagrin of the apparently victorious owners, this may mean that some 500 players become free to pick their teams by the start of next season. Others would follow. Thus the courts may do what the strikers could not. Better if the two sides had followed the route just taken by the basketballers.

Babies

Whose property?

AMERICA'S courts are being asked to rule in ever more, and ever more unusual, disputes over adoptions, visiting rights, surrogate births and abortions. Boyfriends fight girlfriends. Fathers fight mothers. Potential fathers fight potential mothers. Adoptive mothers fight natural and surrogate mothers. Judges agonise. Society wonders.

Last month, for instance, a judge in a Superior Court in New Jersey decided that Mrs Mary Beth Whitehead Gould did, after all, have rights to see the daughter she bore,



for a fee of \$10,000, for a woman who felt that her health would not stand a pregnancy. As soon as the child, who became known as Baby M, was born two years ago, Mrs Whitehead Gould wanted to keep her. One judge ruled last year that she must stick to her bargain, and stripped her of her parental rights. Now, however, she is to be allowed broad, and increasing, rights to see her daughter at home: for six hours one day a week at first, three days a fortnight after September, longer visits next year. Both the natural mother and the adoptive couple are barred from cashing in on the case through public discussion or television deals.

With luck, Baby M will now be out of the courts and the public eye. The nine-month-old daughter of a Navajo girl from Arizona may not be so lucky. A white couple from San Jose in California want to adopt her. They have looked after her, at her mother's request, since her birth; indeed, they sheltered her mother before the birth. But the Navajo tribe fears losing one more of its children to white families. And the Indian Child Welfare Act of 1978 empowers tribal courts to make custody decisions about such children. Before the law was passed, Indians had to stand by while many of their children were placed in white orphanages or with white families. There they had access to schools and hospitals, but not to their Indian heritage. Under a temporary agreement, the white couple can keep the child but not adopt it.

Fathers are also demanding their rights. Last month the Supreme Court agreed to hear the plea of Mr Edward McNamara, an



New heights for basketball

AMERICAN SURVEY

unmarried father who wants to be allowed to see his daughter. He did not even know that he had become a father until two weeks after his daughter was born; soon after that she was sent to foster-parents by her mother. She is now six. A Californian court has ruled that with the passage of so much time the man has lost his parental rights and that even visits from her father might damage her relations with her foster parents, who are considering adoption. Yet Mr McNamara has been in and out of court since late 1981. As the judge observed sombrely, "Any resolution of this case would in some sense be unfair."

Abortions without the consent of the father are also before the courts. A husband in New York is suing for compensation and divorce from his wife because, he says, she had an abortion without his knowledge or consent. This used to be against the law in some states, but in 1976 the Supreme Court overturned a law in Missouri that required a wife to get her husband's permission to have an abortion.

Boyfriends are also claiming rights. One went to court in Indiana last month to stop a woman having an abortion, even though she said he was not the father of the child she was expecting. Nonetheless, he won a court order forbidding the abortion. The courts will now be asked whether the original order was legal. The National Right to Life Committee, an anti-abortion group, represents the boyfriend; the American Civil Liberties Union represents the woman. More such cases can be expected.

Congress

Ethics are infectious

ONCE upon a time everyone knew the difference between right and wrong. Then there was Watergate. Next the word ethics passed into the currency of political discourse. It applied to members of the executive, past and present, but not in the same way, apparently, to members of Congress. Now that may change. The Senate has voted (with only ten senators present) to apply to former members of Congress the rules on lobbying that other government officials have, since 1978, been meant to observe.

If the House of Representatives agrees, the lobbying of their former colleagues, friends and members of the executive branch during the first year after leaving office will be forbidden to ex-members of Congress. And staff members earning more than \$66,400 a year will be forbidden for a year to lobby anyone employed in the chamber that they have served. Former govern-



Virtue encroaches on the Capitol

ment employees will no longer be allowed to work for international organisations, including the United Nations, for 18 months after they have left their jobs (thank Senator Jesse Helms for that). And even lobbying on behalf of foreign governments and firms will be forbidden for 18 months. Had this provision been in effect before, the former chairman of the House Budget Committee, Mr Jim Jones, would have been unable to work for Toshiba, a Japanese company that was the object of many congressmen's anger in the recently passed trade bill.

Laws are one thing. Policing them is another. On this Congress does not have a good record, despite ethics committees that are supposed to watch over members. Last year the House committee reprimanded Representative Austin Murphy for various infringements: allowing another member to cast a vote for him, using government resources in the interests of his law firm and keeping a non-working staff member on the government payroll. But this was the first time it had stirred itself to issue even a reprimand, its lightest penalty, since 1984.

In any event, ethics charges seem to count for little against a sitting member, especially in the House. Mr Murphy has just won his primary election and will be returned unopposed in the autumn. Mr Mario Biaggi may not be so fortunate. He is currently appealing against a prison sentence for accepting bribes. Daringly, the ethics committee has recommended that he be expelled from the House.

\$2 billion poorer

PRESIDENT REAGAN is fond of suggesting that social ills can be solved as easily by the charitable instincts of Americans as by government largesse. He can now point to Mr David Packard, co-founder of Hewlett-Packard, Silicon Valley's first and most famous garage-born company, as a fine example.

Mr Packard has decided to give \$2 billion to charity. The money, which is probably more than two-thirds of Mr Packard's fortune, comes in the form of Hewlett-Packard shares, which have appreciated nicely since 1939 when he and Mr William Hewlett put \$538 into their venture. Over the next few years Mr Packard's shares will be transferred to the David and Lucile Packard Foundation, named after its benefactor and his late wife. The gift is thought by the Foundation Centre in New York to be the largest ever made to a private foundation.

Last year *Forbes* magazine put Mr Packard fourth on its list of the 400 richest people in America. Now he will rank lower. But by giving so much money away, he may avoid losing much of it to the taxman. He also ensures that it will be used to further projects dear to his and his family's hearts. In line with Mrs Packard's interests, for example, the foundation will spend much of its windfall on children's health. Some will also go for family planning in poor countries, and some for science and engineering research and teaching. At present the foundation has roughly \$145m at its disposal and makes grants each year of about \$10m. The shares will make it one of the half-dozen richest foundations in America.



Garage-man turned philanthropist



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INTERNATIONAL



The Israelis go knocking on Hafez Assad's back door

FROM OUR ISRAEL CORRESPONDENT

ISRAEL'S push into south Lebanon on May 3rd was described quaintly by one Israeli general as a "door-knocking" operation designed to hunt down Palestinian guerrillas. On the first day of the affair several hundred Israeli soldiers banged on a lot of doors in a few Muslim villages in the Arkoub area on the foothills of Mount Hermon. They found little to complain of, but handed out leaflets warning villagers against helping Palestinian gunmen infiltrate across the Israeli border. Spokesmen said the troops would be home within 24 hours.

That appears to have been a tactical fib. A day later the Israelis were still in Lebanon, and deeper in. A battalion of paratroops, covered by an artillery barrage and helicopter gunships, fought its way into the village of Maidoun, well north of Israel's self-declared "security zone" and within three miles of positions held by the Syrian army. There about 40 gunmen from Hezbollah, the pro-Iranian fundamentalist group, were killed in a day of fighting; so were three Israelis. The Syrian-held town of Mashgara came under Israeli shellfire. By evening the Israelis had dynamited much of Maidoun and returned home.

This operation, the biggest of its kind for over two years, was still far smaller than the "Litani" operation of 1978. That first

large Israeli incursion into Lebanon was set off when gunmen from the Palestine Liberation Organisation landed on an Israeli beach, hijacked a bus and killed 33 Israeli civilians on the Haifa-Tel Aviv highway. It brought the blue-helmeted soldiers of the UNIFIL peacekeeping force to the rolling country beyond the border and it has kept Lebanon's wild south in the news ever since.

Unlike the Litani operation, or Mr Ariel Sharon's full-blown invasion of Lebanon in 1982, the latest operation was mainly demonstrative in purpose. Palestinian guerrillas have made eight infiltration attempts across Israel's borders since January. One, on April 26th, resulted in the death of two Israeli soldiers, including a lieutenant-colonel. Until this year Israelis had got used to the idea that the narrow "security zone" they set up in 1985 after the end of their Lebanon war, and the largely Christian "South Lebanon Army" that polices it, were enough to prevent guerrilla infiltration. The recent attacks prove that they are not.

A glance at the map explains why. The north-western slopes of what the Israelis called Mount Hermon, and the Arabs know as Jebel ash-Sheikh, lie partly in Israel's "security zone" and partly in the no-man's-land that separates it from the Syrian-controlled Bekaa valley to the north. In the 1970s,

when Mr Yasser Arafat's PLO forces were freer to operate in south Lebanon than they have been since the 1982 invasion, the Arkoub was known as "Fatahland" because of its importance as a forward base for Palestinian operations against Israel.

Mr Arafat's men are out of the game this time, confined to their camps in the Sidon and Tyre areas on the coast and pinned down in an uneasy truce with Amal, the mainstream Lebanese Shia movement led by Mr Nabih Berri. Amal wants Israel and its allies out of Lebanon but is much less keen about the consequences of mounting cross-border attacks on Israel; it therefore keeps the PLO on a short leash. The Shia villages controlled by Amal in the south—roughly in the area where UNIFIL is deployed—do not welcome Palestinian guerrillas. The PLO has recently been co-operating mainly with Amal's smaller rival, the Hezbollah. That is presumably why Maidoun, which Hezbollah had turned into a fortified base, was singled out for Israeli retribution.

There in the east, things are different. The Palestinian groups encamped in the Bekaa under the protection of Syrian anti-aircraft missiles have been using the rugged guerrilla country of the Arkoub as a hole to slip through Israel's forward defences. The largely Sunni Muslim and Druze villages where the Israelis and their SLA allies carried out many of this week's searches contain Lebanese communists and other left-wingers passionately sympathetic to the Palestinians. The villagers have a tradition of smuggling and an intricate knowledge of the safest paths to the border.

The Palestinian uprising in the Israeli-occupied West Bank and Gaza Strip has encouraged Palestinian guerrillas in the Bekaa to step up cross-border raids, the success of which the Israelis blame on Syria. But it is



INTERNATIONAL

not clear how much practical Syrian help the Palestinians really receive. The fashionable intelligence holds that President Hafez Assad, a master of manoeuvre and brinkmanship, is currently enjoying a reconciliation of sorts with his old enemy, Mr Arafat. A gunfight in Beirut this week between Mr Arafat's men and Colonel Sayed Abu Musa's Syrian-backed Palestinians suggests that a full meeting of minds is still far away.

Israel wants to discourage Syria from giving Palestinian infiltrators more help, but also respects Syria's strength. The Israelis therefore went to unusual lengths to make it clear that this operation was a limited one; they appear to have leaked their plans, in advance, to American television networks. One result was that any Kalashnikov-toting Palestinians in the Arkoub had slipped away

long before the arrival of the Israeli armoured columns. The Hezbollah men who stayed, and died, in Mashgara were either recklessly courageous, or made the fatal mistake of expecting their proximity to Syrian lines to save them.

In the old days before the 1982 invasion, Israel and Syria used to talk about invisible "red lines" in Lebanon beyond which neither side would go without provoking a military response from the other. The understanding held up well enough. Israel could not have expected Operation Door-Knock to round up many Palestinian guerrillas. But its soldiers brushed close enough to the Syrian positions in Lebanon to remind Mr Assad that there are still plenty of red lines on Lebanon's map. Some of them are painted in blood.



Cuba's new image

Crusty old caudillo seeks rich friends

PENURIOUS isolation is losing its appeal. In the decade after he took power in Cuba in 1959, Mr Fidel Castro set about exporting revolution to his Latin American neighbours. All except Mexico, whose aging revolutionaries had a soft spot for their wild young cousin, responded by severing relations with him. Now Mr Castro is exporting charm instead.

This is excellent news for Cuba's political prisoners. Last year the United States threatened to bring a resolution criticising Cuba to February's meeting of the United Nations Committee for Human Rights. Mr Castro headed off that embarrassment by letting opposition human-rights groups hold meetings and press conferences; and then by inviting foreign human-rights activists, the Red Cross and a British television crew to inspect his jails. The UN committee has now put off its vote on the American resolution until next year.

It does not take much to improve on Cuba's past performance. One American lawyer who visited the country in February reported that the beatings and executions of former times had abated, but some prisoners are still kept in appalling conditions and fed just enough to stay alive. The number of prisoners is declining. Returning from Cuba on April 3rd, a team from Amnesty International said that about 600 political prisoners remained, down from the 4,500 the government admitted to a decade ago. On April 19th nine more were released.

All this adds to the favourable impression created in Latin America by Mr Castro's slightly more tolerant attitude to the Roman Catholic church in his country. Not many Cubans are practising Catholics, but more than half of those buried in Havana's main cemeteries last year received a Catho-

lic funeral—suggesting that official discouragement, not changing beliefs, is the main explanation for dwindling congregations. Mother Teresa, and a few foreign priests, have now been allowed to work in Cuba. Last year, for the first time since 1971, the Cuban church was allowed to import 30,000 Bibles.

El Salvador and Honduras still dislike Mr Castro, who provides 500 or so military advisers to the Sandinist government in Nicaragua and admits to backing the left-wing Salvadoran guerrillas. But in January the Cuban foreign minister toured Panama, Mexico, Uruguay, Argentina and Brazil, offering to withdraw the advisers from Nicaragua. All the larger Latin democracies except Colombia have renewed diplomatic relations with Cuba, and Colombia's informal ties are growing.

Good show, try harder

At the Latin American summit in Mexico last November, Brazil joined Mexico in suggesting that Cuba be readmitted to the Organisation of American States, from which it was ejected in 1962; the rest of the delegates agreed to give the idea serious thought. Before the Central American presidents met in January to see how things were going with their plan to bring peace to that part of the continent, Guatemala suggested that Cuba should be invited along. Chumminess with Mr Castro has become a useful badge for Latins keen to assert their independence from the United States.

But Cuba is growing friendlier with that country too. In November the United States and Cuba agreed to revive an immigration agreement which Mr Castro suspended when America began propaganda broadcasts to Cuba in 1985. Cuba has agreed to

take back 2,700 Cuban criminals whom the Americans have been trying to deport since Mr Castro ejected them in 1980. In return, the Americans have promised to give visas to up to 20,000 Cubans each year, so helping Mr Castro to rid himself of dissidents. Cuba has also pleased the Americans by joining in this week's peace talks about Angola, where Cuba keeps a small army.

The lure of friendship grows as Cuba's economy sickens. The island owes Russia an estimated 8 billion roubles (about the same number of dollars at the least implausible exchange rate). Mr Castro has suggested that Russia should cancel the debt as a "matter of principle". That might have worked with the old men who used to run the Kremlin. The cost-cutting Mr Mikhail Gorbach is less indulgent. He has already reduced the aid Russia gives Cuba by buying its sugar at prices way above those of the market; and he hints that more cuts are to come.

Mr Castro's improving connections with the non-communist world are helping to overcome Cuba's feelings of isolation but not, so far, to cure its economic maladies. Non-communist countries account for less than a tenth of Cuba's trade, and imports from them cannot grow until Cuba earns more hard currency. Latin Americans are in no position to sell their goods on credit.

Some intellectuals in the Cuban Communist party are known these days as *perestroikistas*; but they seek no far-reaching economic reform. In 1986 Cuba's party congress adopted "rectification" as its slogan for reviving the economy. It has meant the opposite of Russia's and China's current reforms: more power for central planners, a

clampdown on the few existing pockets of private enterprise, and an exhortation to workers to accept "moral incentives" instead of material ones. Splendid isolation is easy to end. The penury lingers on.

Chile

Suddenly, doubt

FROM OUR CHILE CORRESPONDENT

CHILEANS who like General Augusto Pinochet have long dismissed his opponents as divided and disorganised. These days their own coherence is in question. On April 22nd the general assured a crowd of supporters that, in the presidential plebiscite expected at the end of the year, Chileans would be asked whether they "wanted President Pinochet to continue or not". This suggested that he, and nobody else, could be the government's candidate.

Since the choice of candidate is supposedly a matter for the military junta, which is expected to come to a formal decision in June or July, this was an indiscretion. Chile's naval, air force and police commanders, as well as senior members of the government, doubt the attractions of another eight years of Pinochet. Perturbed officials hastily insisted that the general had not declared himself a candidate, but had simply "explained the constitution with great clarity". The general's remarks went unreported in the government newspaper, *La Nacion*.

General Pinochet can no longer assume automatic loyalty, even from those close to him. An opposition campaign to register voters, led by the Christian Democrats, has done well: some 6m people are registered, and many of them are likely to vote no if the general is the candidate in the plebiscite. Chile's generals are an obedient lot, but will think twice before obediently backing a user. General Pinochet's junta colleagues from the navy and air force have lately been contradicting the general's line that Chile would be in chaos if the government candidate lost in the plebiscite.

Recent public-opinion polls indicate that General Pinochet could muster only about 30% of the vote. The naval member of the junta, Admiral José Toribio Merino, has said he would prefer a civilian candidate; the air-force member, General Fernando Matthei, and the national police chief, General Rodolfo Stange, think likewise. One possibility is Mr Ricardo Garcia, the present foreign minister. In his previous job, as interior minister, Mr Garcia was known as a decent man who cared about human rights and kept close relations with the Catholic church, which has been a persistent critic of the general.

General Pinochet is not an accommodating man; but one thing that might per-

suade him against running is the insistence of his junta colleagues that the successful candidate, if he is also the commander of one of the armed forces, must relinquish his military job on taking office. General Pinochet remains on active service and uses his command of the army to buttress his authority. As the plebiscite approaches he might decide to give up the presidency rather than his five stars. That way, he could still try to rule Chile from the barracks.

The junta's nominee will be the only candidate in the plebiscite. Only if that candidate is rejected will Chile move on to a competitive—and confusing—presidential election. The opposition Christian Democrats, Chile's biggest party, are split between leftists and centrists. Rifts have opened up inside Renovacion Nacional, the biggest pro-government party: in March General Pinochet's supporters inside Renovacion Nacional boycotted a party election. Nothing looks quite as sure in Chile's politics as it used to.

Jamaica

Going to pot

FROM A CORRESPONDENT IN JAMAICA

THE chances of a victory for Mr Edward Seaga, Jamaica's prime minister since 1980, in the election due later this year look like being reduced by his attack on the drug business. His government's anti-cannabis campaign, run in partnership with the Americans, has angered both the drug dealers and the thousands of small farmers who depend on the crop.

Cannabis, known locally as ganja, is probably Jamaica's biggest export. The poor

grow it, smoke it and sell it to tourists or to middlemen; some of the rich make millions by exporting it to America. But many clean-living middle-class Jamaicans deplore its effects on the country's efficiency and morals.

In the early 1980s Mr Seaga, encouraged by the Reagan administration, launched the "Buccaneer" campaign to rid the island of the profitable weed. Last year an American helicopter—piloted by a woman, whose ruthlessness much impressed villagers—sprayed fields in the mountainous areas to which the crop has retreated. The campaign has cut production and caused anger among the ganja growers and other farmers who say that the spraying has killed livestock. Yet ganja farmers in the prime growing areas of the north say they will be planting more this year than last. They hope the approaching election will encourage the government to take a more lenient view of their industry.

Publicly, the government remains adamant, and receives lavish American praise. Mr Elliot Abrams, the State Department's Latin America man, has said that the eradication programme is "terrific" and that Mr Seaga "has done everything he could to help us out". On April 8th, however, the prime minister had to reject allegations, made by a convicted drug dealer to a sub-committee of the American Senate, that he himself was implicated in the drug trade. Mr Seaga denied suggestions that he owned property in the Cayman Islands or had drug money sent there from Jamaica. "I own no property or assets in Cayman," he said. "The commissioner of police has been subjected to the same smear tactics as I have been, a deliberate ploy to weaken the effectiveness of the police force."

Ganja is not Jamaica's only blight. During the past five years the use of cocaine has grown alarmingly, even though it is not pro-



Sun, fun and ganja

INTERNATIONAL

duced in the island. Ganja smugglers making use of secret landing strips have added cocaine to their aircraft's cargo, thereby turning Jamaica into a cocaine trans-shipment route between South America and the United States. Cocaine is now easily available in the island, and its appearance in schools is worrying Jamaican parents.

The opposition People's National party, led by Mr Michael Manley, has taken as firm a public stance against drugs as Mr Seaga's Jamaican Labour party; but it stands to benefit from Mr Seaga's troubles. Ganja growers remember that times were easier for them when Mr Manley was prime minister in the 1970s. They know that he dislikes co-operating with the United States, and they hope that, once back in power, he would keep America's helicopter off the island and its influence out of Jamaican affairs.

The drug problem, together with the poor shape of the economy and a reaction among blacks against being ruled by a light-skinned prime minister, could restore the slightly browner Mr Manley to power later this year. But not everybody is swept along by his current wave of popularity. As one fisherman and part-time ganja grower remarked: "They bawl Seaga now, but they gonna bawl Manley more when he get in."

Sudan

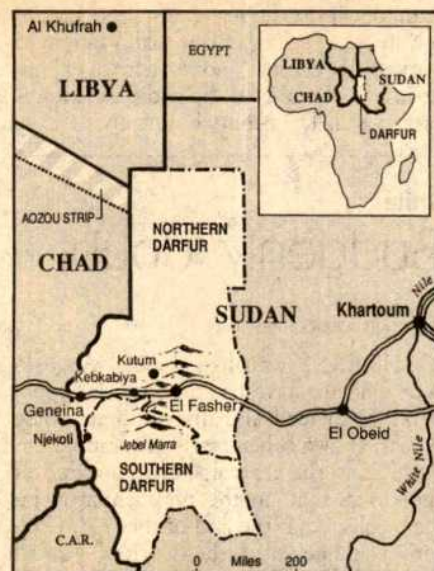
Bandit country

FROM A CORRESPONDENT IN DARFUR

HIGHWAY robbery is a way of life in western Sudan. Folklore tells of the lorry passenger who, seeking mercy, calls on his assailants to have faith in God. The robber replies: "If I had faith in God I wouldn't be doing this. Empty your pockets."

Sudan's Darfur provinces are immense, and the few people who live there are nomads with a fighting tradition. Their tribal loyalties spread across the frontiers with neighbouring, and warring, Chad and Libya, both of whose regimes regard the provinces as useful ground and are arming local warlords. Kalashnikov automatic rifles sell for the equivalent of \$40. Gangs with political connections get them free.

Since the Chadian government of Mr Hissène Habré beat up the Libyan army last year, the Libyans have placed men in Northern Darfur ready to make raids into Chad. Colonel Qaddafi's so-called Islamic Legion consists of some 1,500 Mauritanian, Malian and Druze mercenaries, with its main base near the town of El Fasher. Libyan officials described as aid workers are recruiting



among the local Arabic-speaking nomads.

A rival group consists of nomads living athwart the Chad-Sudan border, followers of the Chadian dissident leader Acheikh Ibn Omar. His Conseil Démocratique Révolutionnaire is also backed by the Libyans, but may not be entirely under their control. Its men collect weapons from the Al Khufrah oasis in southern Libya and carry

Smelling a Brazilian rabbit

FROM OUR BRAZIL CORRESPONDENT

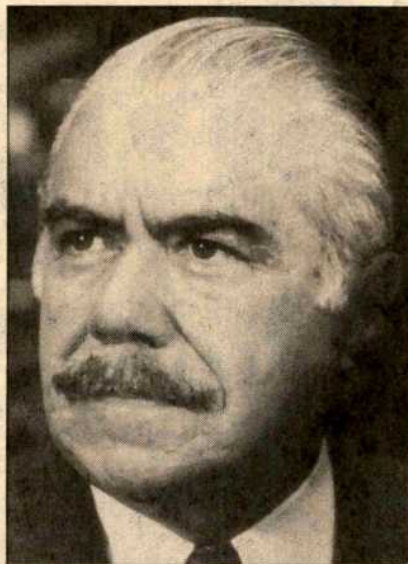
WHEN Brazil's armed forces handed power back to the civilians three years ago, most people decided there was no point in ferreting into old scandals. The ferrets quickly found a new rabbit-hole. A whiff of corruption soon began to rise from the civilian government of President José Sarney. Rumours, suspicions and a few solid facts have by now implanted in many Brazilians' minds the picture of an administration rife with influence-peddling, nepotism and conflict of interest.

Now that Brazil is an open society, newspapers and politicians are free to make charges without much evidence. The country's politics has always involved using public money to promote private careers. Under the distorting influence of inflation and attempts to cure it, public servants have seen the real value of their salaries dwindle. Policemen, customs officers, building inspectors and the like appreciate a little extra cash in return for doing their jobs.

The government does business its own funny way. Last year contracts worth \$2.5 billion for building a north-south railway were secretly awarded to 18 engineering companies before the transport ministry

had opened the bids. Mr Sarney's planning minister, Mr Anibal Teixeira, was forced out of office three months ago on another matter, and has since been indicted on charges of corruption.

The senate has set up a special commission of inquiry into corruption, which has



Sarney intactus

heard friends and foes of the regime growling at each other for several weeks. For the government Mr Antonio Carlos Magalhães, the communications minister, says the commission's intentions are strictly political. "Many of its members should be in the dock themselves," he observed, with the tone of someone who knows a few secrets. President Sarney himself claimed that the commission's witch-hunt was intended to drive him "to resign or commit suicide".

The president probably has nothing much to fear. The commission has put few proofs behind its cloud of innuendo. Mr Dilson Funaro, a former finance minister, complained that his name had appeared on a dubious decree which he had not signed. His successor, Mr Luiz Carlos Bresser Pereira, told the commission that "there are corrupt people close to the president", but faltered when asked to name them. The air minister, Brigadier Octavio Moreira Lima, said "there is a frightening escalation of corruption." But facts were few.

The opposition is dismayed that Mr Sarney may now remain in office until March 1990. But it thinks the whole idea of democracy might be damaged if a trail of corruption leads to the president's palace. The commission's labours will probably be allowed to peter out, after enough mud has been splattered about.



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Pre-tax Profit	IR£154m + 156%
Earnings per Share	31.6p + 108%
Dividend per Share	3.97p + 10%

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INTERNATIONAL

them across the desert through Kutum and Kebkabiya (where even the Sudanese army dares not go) to their main base at Njekoti on the border between Chad and Southern Darfur. In March they tried to take control of the Jebel Marra mountain, straddling the road to the frontier at Geneina. The local Fur people, to whom Jebel Marra is sacred, held off the invaders. The Sudanese army tried to intervene, and lost 13 men.

The Sudanese government can barely manage to control its capital, Khartoum, and has practically no power in the Darfur outback. The prime minister, Mr Sadiq el Mahdi, owes favours to Colonel Qaddafi for help when he was in exile, and finds it prudent to deny that there are any Libyans in Darfur at all. The Fur people are in exchange turning their backs on the Khartoum government. Mr Sadiq's loyal supporters, the people of the Ansar religious sect and its secular arm, the Umma party, have their roots in western Sudan, where the original Mahdi, Mr Sadiq's great-grandfather, began his successful campaign to oust the British and Egyptians in the 1880s. Now the party's regional unity is fading.

The Darfur Development Front, once a local pressure-group, is starting to look more like a regional party under the traditional Fur rulers. In March 40,000 of its supporters turned out at a rally in Khartoum. On home ground they have organised a Fur militia in the Jebel Marra area, enlisting and arming young people who would formerly have been counted among Mr Sadiq's followers. This organisation grandly calls itself the Federal Army of the Sudan. It is only one of the regional forces that may soon split the country into fragments.

South Africa

Lost sheep

FROM OUR SOUTH AFRICA CORRESPONDENT

MANY an Afrikaner has marched rightwards out of South Africa's ruling National party and into the newspaper headlines. When Afrikaners stray leftwards it is much odder, and more dramatic. The most wanted man in South Africa at the moment is Mr Hein Grosskopf, the Afrikaner son of a university professor and nephew of an appeal-court judge. The police suspect him of carrying out two bomb attacks in the name of the outlawed African National Congress. The most recent of them claimed three lives in the town of Krugersdorp, near Johannesburg.

As a schoolboy Mr Grosskopf was a brilliant debater and a *Voortrekker* (a sort of boy scout), and he was elected junior mayor of Johannesburg in 1981. Now he has a price of R50,000 (\$23,000) on his head. Ordinary Afrikaners simply cannot understand why

All one now

ZIMBABWE is now just another African one-party state. During April Mr Joshua Nkomo's ZAPU party agreed to wind itself up, and finally merged into the majority ZANU party under the country's president, Mr Robert Mugabe. The people will have less electoral choice; but not necessarily less freedom.

ZANU began existence in 1963, as a breakaway faction of young men fed up with Mr Nkomo's heavy-handed leadership of the clandestine independence movement; most were from the majority Shona-speaking peoples of what was then Southern Rhodesia. Mr Nkomo and his ZAPU friends were from the Ndebele tribe. So Zimbabwe came to independence in 1980 tribally divided.

Mr Nkomo is old and unwell, his Ndebele followers weary of struggling against Mr Mugabe's people. A few of the Ndebele (supported, say both Mr Mugabe and Mr Nkomo, from South Africa) carry on a campaign of terrorism in

Matabeleland. While Mr Nkomo was in opposition, terrorists could persuade their fellow-tribesmen to help them fight the "Shona government". Now the dissidents are isolated, and Matabeleland's farmers, many of them white, should sleep easier. For the first time in six years, plentiful rain has fallen there. The people and their cattle can thrive.

One-party states generally mean repression and over-government. Mr Mugabe wants to build some self-criticism into his by giving senior jobs to his former ZAPU critics (including Mr Nkomo, made a vice-president). Since much of Zimbabwe's industry and commercial farming is run by white people, he has brought some of their leaders into public office too. Now he has to put right an economy starved of export revenues, and walk the line between dislike of, and economic co-operation with, South Africa. If anybody can do it, it will be Zimbabwe's newly unchallenged leader.

one of their tribe would work for the ANC. Some say it must have been for money. But—if the police are right to accuse him—Mr Grosskopf would not be the first Afrikaner to take up the "armed struggle". Bram Fischer, a lawyer and son of a judge-president of the Orange Free State, died in 1974 after being jailed for life in 1966. Mr Breyten Breytenbach, an Afrikaner poet, was imprisoned for terrorism between 1975 and 1982. Mr Karl Niehaus, a student, was sent to jail for 15 years in 1983 for trying to blow up a gas storage depot.

Not all Afrikaner dissidents take up violence. Others depart into unorthodox opposition, or glum silence. Mr Frederik van Zyl Slabbert, who used to lead the tepidly liberal Progressive Federal party, despaired of conventional white politics, and last year led a band of fellow Afrikaners, including writers and journalists, to Senegal, where they talked to the ANC at the invitation of Mrs François Mitterrand. Mr Beyers Naude and Mr Nico Smith have both deserted the Dutch Reformed church and the secret Afrikaner *Broederbond*. Another disillusioned politician, Mr Wynand Malan, remains in parliament but tries to talk to blacks outside that restricted—and restricting—body.

Other dissenters lurk within traditional Afrikaner institutions. Students at the University of Stellenbosch—*alma mater* of many Afrikaner leaders—have protested against the government's policies. Mr Albert Nothnagel, a National party member of parliament, has dared to insist that the ANC is too important to be kept out of South Africa's future.



Every Boer has a rebellious streak

Still, Mr Willem de Klerk, who was squeezed out of his position as editor of the Sunday newspaper, *Rapport*, reckons that fewer than a quarter of the National party's members want Mr Botha to move faster towards racial reform. There is no chance of mass defections to the left, to match the desertions from the National party to the ultra-right Conservative party. It takes courage to be a liberal Afrikaner. Those who are may end up lonely, and out of sympathy with other South African white liberals, most of whom tend to be rich, and unsympathetic, English-speakers.

EUROPE

The turbulent other half

The communist half of Europe is entering a time of troubles which will test the limits of freedom under Mikhail Gorbachev. His attempt to change Russia is already starting to produce upheavals in Eastern Europe, notably in Poland and Hungary. Look, first, at unhappy Poland

PICTURES of the Black Madonna of Czestochowa were back on the railings of the Lenin shipyard in Gdansk, the scene of the famous 17-day strike in August 1980 which gave birth to Solidarity. That strike's hero, Mr Lech Walesa, was there again. So were Solidarity slogans. The issues are the same: the protests started with demands for higher wages to make up for higher prices imposed by the government, but demands for more political freedom soon followed. And the warnings from the government are the same: it will stand firm and will tolerate no disorders. Is Poland about to experience a re-run of 1980?

The similarities are valid, but incomplete. Both workers and government have learnt lessons since 1980. On May 5th the police moved in to clear strikers from the giant Nowa Huta steelworks near Krakow. By arresting strike committees early, instead of waiting while the protests gathered unstoppable strength, the authorities are clearly hoping to kill the trouble at its birth.

It is true that, as in 1980, things have moved fast. Strikes quickly spread from a few Bydgoszcz busmen to Nowa Huta, and then to many places beyond. On May Day demonstrators clashed with the police in several cities. The Politburo went into emergency huddles. But Poland has changed in the past eight years, and so has the world outside it. This "crisis", if that is not too strong a word, is different.

First, Poland's economy is in even more of a mess than it was in 1980. Its foreign debt is higher and its living standards are lower. According to official statistics, more than 60% of Poles live below the poverty line. Huge price rises, as usual in Poland, were the last straw. But this time a lot more Poles are aware of the hard economic reality.

A second big difference is the role of Solidarity. The government justifies its arrest of prominent Solidarity people by claiming that they are the troublemakers. The truth is that these strikes took the old Solidarity leadership, including Mr Walesa himself, by surprise. Ever since April 25th,

the day of the transport strike in Bydgoszcz, Mr Walesa and his peers have been trying to regain the initiative from younger, more radical activists.

Mr Walesa provided the hint of a rallying theme behind the strikes by pointedly demanding *perestroika* for Poland. This reflects a third vital difference between now and 1980. Then there was Brezhnevite stagnation in the Soviet world. Now, under Mr Gorbachev, reform is in fashion, even though the limits of permissible change are unclear.

If Russia can abandon its imperial position in Afghanistan, many Poles reason, can it not be persuaded to do the same in Poland? False optimism, perhaps, but the mere presence of Mr Gorbachev in the Kremlin has changed the calculation. Poles have noted that it is now fashionable in Russia to say that "all ways to socialism" are legitimate. It is not even entirely clear whether the "Brezhnev doctrine", the excuse to invade Czechoslovakia in 1968, is still in force.

Beyond all this is the memory of what happened to the high hopes of August 1980. Most Poles are stingingly aware that their government went back on its promises when it outlawed Solidarity after imposing martial law in 1981. They will not accept mere promises again. If they can get it, they will insist on a real share of power.

Can General Jaruzelski's government possibly offer that? Its hand is weak. The Polish communist party lost most of its remaining credibility when it was defeated in last October's referendum. It had tried to forestall an outcry over the price rises by obtaining a public mandate for them. It failed, by its own stiff referendum rules. The government then said it would soldier on with its feeble economic reform programme even without a mandate. The strikes that have been taking place since April 25th are the Polish way of saying "no you don't".

An across-the-board attempt to buy the strikers off with big wage rises (like the one given to the strikers at the Stalowa Wola works last week) would make inflation still



Same faces, same protest, same Gdansk

worse. That would undermine the government's entire economic policy. Political concessions are even harder to contemplate. Democrats might suggest that the government could form a coalition with some Solidarity people and leaders of the Catholic church, in the hope that this would carry Poland through the years of austerity needed to revive the economy. But it is not clear that there would be enough takers for a pact with the general. And such a pact would destroy the communist party's "leading role": which requires either Mr Gorbachev's unlikely approval, or Polish defiance of Mr Gorbachev.

Statements by Mr Walesa and other leaders of (officially non-existent) Solidarity make it clear that they know what a ruin the economy is; but none of them has come forward with an offer to co-operate with the government in rebuilding it. An extra difficulty is that the left-wing element in Poland's opposition—notably the old Workers' Defence Committee—has weakened in the past eight years. The nationalist strand, personified by Mr Leszek Moczulski, has gained ground. Any accommodation with pungent nationalism would be hard for a government that is firmly tied to Russia.

General Jaruzelski's only comfort is that he has the backing of Mr Gorbachev. But Mr Gorbachev too must be dismayed by events in Poland. If he were to let General Jaruzelski strike a "patriotic" bargain with non-communists in Poland, non-communists elsewhere in Eastern Europe would ask for the same thing. If he opts for a dose of repression, that dose may have to be heavy. If it included intervention by the Soviet

EUROPE

army, Mr Gorbachev would destroy the good name he has built up for himself in the West. He must be wishing that it was not a writer of fiction who once described Poland as "a country that doesn't exist".

Soviet Union

Indignant, Omsk

TIME was when a judiciously placed article in a Soviet newspaper—even a single well-chosen sentence in a *Pravda* editorial—was all that was needed to alert good Soviet citizens to a change of policy in the Kremlin. Imagine the confusion as Communist party members now scour their daily papers and find not one but two or three party lines to choose from. Public debate on this scale, let alone political letter-writing (see box), has never before muddled Soviet politics. If the brawl in the letters columns is anything to go by, there could soon be black eyes in the Kremlin.

There is another novelty. For the first time a letter-writer has raised the possibility of the party's boss being shown the door. A correspondent from Nizhnevartovsk, a town in western Siberia, told the newspaper *Sovietskaya Kultura* on April 30th that, unless the party's rules are changed, anti-reformers on the Central Committee could yet unseat Mr Mikhail Gorbachev: "the support of the party apparatus for our leader is by no means general or unanimous, or always sincere."

Worried-from-Nizhnevartovsk was no doubt selected for publication to alert Mr Gorbachev's supporters to the sharpness of the struggle now going on behind party

doors. At stake is the fate of the reform programme Mr Gorbachev wants next month's special party conference to approve. The conference is due to discuss everything from the next steps in *perestroika* (the "restructuring" of the Soviet economy) to legal reform and more power for the soviets, or local councils. The issue causing the biggest bother is reform of the Communist party itself.

Mr Gorbachev first raised the idea of changing the party's rules at a Central Committee meeting last year, to a resounding silence from his comrades. The ideas he set out then—limiting the tenure of officials in party organisations, holding party elections by secret ballot, and making party committees accountable to the rank and file—were raised again in a letter published by *Pravda* on May 2nd, this time from a middle-ranking official in the aviation ministry in Moscow. The letter attacked Stalin for turning party members into "soldiers" who had to obey orders from the top. It also accused party members of "careerism, individualism,

self-seeking . . . drunkenness . . . arrogance, incompetence and bribery."

And the remedy? First, a far-reaching purge of incompetents and a reduction in party numbers. "After all," as the author points out, "300,000 Bolsheviks were enough in October 1917!" Today 19m party members shuffle papers, tell managers how to manage, and generally muck things up. This would be followed by direct elections by party members of all party bosses from the regions downwards. New laws would be introduced which make members who commit crimes even more guilty than their non-party fellows. That would reverse today's practice, by which Communists who break the law often escape prosecution and get nothing more than a slap on the wrist from the local party organisation.

Mr Gorbachev would love to get that list through next month's conference. The fact that he has to resort to such novel forms of propaganda for his side of the argument shows he is by no means sure he can.

Men of letters

Dear Russia-watchers,

Have you noticed how Kremlinology is rapidly turning into epistology, the study of letters? Just as the novel-in-letters was a popular literary genre in centuries past (remember Fielding, Laclos, and Russia's own Dostoevsky), letter-writing is now the fashionable form of politics in the Soviet Union. Gone is the time when the line-up on the Kremlin wall told you everything knowable about the power struggles in the Politburo; now it plainly doesn't (just look at how Mr Mikhail Gorbachev and Mr Yegor Ligachev fraternised on Lenin's mausoleum on May Day). These days you have to read the correspondence in the Soviet press.

In one variation of politics-through-letters, a Soviet newspaper publishes a string of (genuine, it seems) readers' letters, and you judge the prevailing balance of power by how many of them are passionately anti-Stalin and how many are pro. More dramatic is the use of letters as a thin cover for the views of top politicians. A reactionary letter published in *Sovietskaya Rossiya* from a certain Nina Andreyeva is really a manifesto for the Ligachev camp, and even gets reprinted in East Germany's *Neues Deutschland*. *Pravda* publishes a counterblast in the form of a letter from one V. Selivanov, but everybody assumes Mr Selivanov is really speaking for Mr Gorbachev.

Why can't Messrs Gorbachev and Ligachev simply speak for themselves, openly? It seems that *glasnost* hasn't yet gone that far: both find it safer to hide behind Andreyevas and Selivanovs. The Politburo is, officially, totally united, so a fully open row is scarcely possible. But the argument through letters at least allows a debate of sorts to take place.

Letter-writing has long been a serious business in Russia—Dostoevsky himself was even sentenced to death (only to be reprieved at the last moment) for reading out a letter from Belinsky to Gogol. In a period dominated by television, it is welcome to find one country where the art of letter-writing lives on.

I hope you will publish this letter in *The Economist*. Your readers will understand that my views in no way represent those of your newspaper.

Yours sincerely,
Sudo Nim
(Car mechanic)



Not everyone likes the new fashion

Hungary

The battle of Budapest

FROM OUR CENTRAL EUROPE CORRESPONDENT

A COUP is in the making in Hungary. The aim is to remove Mr Janos Kadar from the leadership of the communist party, which he has held since 1956. Mr Karoly Grosz, the prime minister, hinted as much on the eve of his visit to Britain this week, by saying that the leadership question would be on the agenda at the conference of the Hungarian party, which begins on May 20th. The once-popular Mr Kadar is suffering from advancing age (he will be 76 this month) and advancing conservatism. Many party members think it is high time he gave way to somebody younger and keener on "rather reforms. Old trees are valuable, said Mr Grosz, but they prevent younger ones growing up in their shadow.

Mr Kadar, fuddy-duddy though he now is, will not be easily chopped down, but Mr Grosz and his fellow-axemen have picked as good a moment as any for the attempt. Mr Mikhail Gorbachev's campaign to shake up the Soviet Communist party has not gone exactly unnoticed in Budapest. In Hungary the cry for brave new policies has been getting louder and louder.

Calls for reform are coming from several directions, most notably from the communist-sponsored mass organisation called the Patriotic People's Front (PPF). Its chairman, Mr Imre Pozsgay, argues for a new election system in which candidates would not be vetted by the communist party, and for a re-defining of the party's "leading role". In the current issue of *Mozgo Vilag*, a sociological monthly, Mr Bela Pokol, a political scientist, suggests the creation of a second chamber in parliament and the ending of censorship.

Mr Istvan Kukorali, a constitutional lawyer attached to the PPF, is calling for free trade unions. Professor Kalman Szakacs, head of the "scientific socialism" department at Budapest's Lorand Eotvos university, thinks it is time to abolish compulsory courses on Marxism-Leninism.

The party does not seem to be listening. During April it expelled four prominent liberals, including Mr Mihaly Bihari, head of the political-science department at the Lorand Eotvos university. They had given offence by addressing the "Democratic Forum", an informal group which is trying to mobilise support for reform. Teachers and students at the nearby Karl Marx university expressed their support for the expellees with astonishing forcefulness, even calling for the resignation of the Central Committee and the government.

The party's leaders will find it hard to ignore all the criticism, because much of it



Man of too many seasons

comes from such prominent party figures as Mr Pozsgay and from the normally cautious Academy of Sciences. The critics are telling the party that, if it is to recover credibility, it must dump its current draft programme for the party's future, which is to be presented to the conference on May 20th. This document must be the most dismal, conservative programme to come from Mr Kadar and his advisers for many years. Mr Grosz has described it as "dry" and too full of generalities. Will he and his friends manage to dump Mr Kadar along with his uninspiring document? Don't count on it. As the proverb goes, old trees have deep roots.

Denmark

Much ado

FROM OUR NORDIC CORRESPONDENT

THE Danish general election on May 10th will be Western Europe's first to be fought mainly on the issue of defence since Mr Mikhail Gorbachev started to convince many Europeans that Russia was becoming a cuddlier neighbour. Opinion polls suggest that the result will fail to dispel the worries of people who doubt the depth of Denmark's commitment to the western alliance.

It is widely expected that the election will once again give the Folketing a left-centre majority. Without openly opposing membership of NATO, this majority will hold defence spending down to a pitifully low level and will further strain Denmark's relations with its allies by seeking the formal creation of a nuclear-free zone covering the whole Nordic region (which, for most practical purposes, is already nuclear-free). Recent opinion polls suggest that, while a majority of Danes still support NATO membership, an equally large majority would, if it came to a

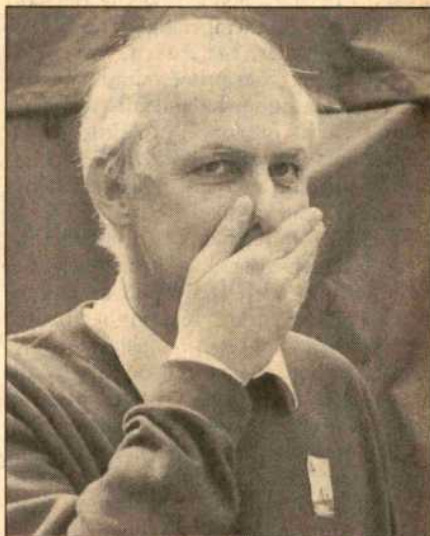
choice, give the establishment of a nuclear-free zone priority over it.

This parliamentary election comes only eight months after the previous one, and is Denmark's 12th in 24 years. It was called by Mr Poul Schlüter, the Conservative party's leader, who has led a minority non-socialist coalition government since 1982. He felt obliged to go to the polls after the Folketing's adoption on April 14th of a resolution requiring his government to remind visiting warships' captains that Denmark does not accept nuclear weapons on its territory.

That resolution had been proposed by the Social Democrats, the largest opposition party, led by Mr Svend Auken. The wording fell short of the terms laid down by New Zealand in a decision that has kept the American and British navies away from its ports since 1985. But a paper that the Social Democrats presented to the Folketing defence committee came closer to the New Zealand formula. This paper said that "a condition of receiving clearance [to enter a Danish port] is that the visiting ship knows and respects the Danish attitude."

It was those words, as much as the April 14th resolution, that led the British and American governments to conclude that Danish policy was about to become incompatible with their policy of neither confirming nor denying the presence of nuclear weapons on their ships. "Extremely serious consequences" for American defence co-operation with Denmark were foreseen by Mr George Shultz, the secretary of state. The British made it clear that their warships would no longer be able to enter Danish waters: the implication being that, in the event of a threat of war, Denmark might not get British reinforcements, as now planned.

Over the past five years Mr Schlüter has endured a series of pinprick defeats in the Folketing on NATO-related issues. In the face of this latest one, he decided that he must take a stand if Denmark was to remain a



Guess what Auken will say after the vote

Not much let or hindrance

IRISH gunmen, in ways not planned by the European Community, have discovered a Europe without frontiers. On May Day, in Dutch towns close to the German border, members of the Irish Republican Army killed three off-duty British servicemen based in West Germany. The killings were the latest in ten years of operations by the IRA in Holland, Belgium and along the West German border. The scarcity of border controls makes the area a congenial neighbourhood for gunmen.

So does the proximity of Amsterdam. The city's pockets of drugs dealers, arms dealers and anarchists make it a good place to hide. Two IRA men who had escaped from Northern Ireland's Maze prison lay doggo in Amsterdam for two years before being extradited, to the unhappy cries of the Dutch left, in 1986. The IRA also buys arms in Amsterdam. There are occasional shopping expeditions for arms in Brussels, too, but the buyers are thought always to have come down from Holland.

Brussels provides other lures besides arms. The strong British presence at the European Commission and NATO provides targets for the IRA. Sometimes the gunmen get it wrong: a Belgian banker was shot dead in Brussels in 1979 after being mistaken for a British diplomat who

lived nearby. Sometimes they get it gruesomely right: a bomb at the Grande Place in the same year killed seven members of a British military band.

The IRA unit that killed the three British servicemen at Roermond and Bergen on May 1st was probably part of a group of Irish terrorists based in Amsterdam. This unit is on the look-out for British targets all the time. Most people have assumed that the killings were a retaliation for the shooting by British servicemen of three IRA bomb-planters in Gibraltar in March. That is not necessarily so, since it might imply more efficient control by the gunmen's commanders in Northern Ireland than is now possible. British moles near the top of the IRA make communications between them and units abroad risky.

Anyway, the units already have their territory marked out. They kill along the West German border as far east as the British base at Bielefeld, where an unexploded bomb was found attached to a British serviceman's car two days after the May Day killings. In 1980 a British army officer was shot dead there. The terrorists have in the past attacked British targets at Rheindahlen, Münster, Osnabrück and Mönchengladbach. The wealth of good roads leading back through often un-

manned border-points makes quick get-aways easy.

Escape will be easier still if all border controls within the EEC are dismantled after 1992. Next month the British home secretary, Mr Douglas Hurd, will go to a meeting of the Trevi group of ministers, who deal with terrorism, to argue that anti-terrorist border controls must stay. People who mistrust the 1992 idea would say that the Community actually needs more of them.



"full member" of the alliance. In effect, he asked the voters to end the muddle that allows the opposition to overrule the government on foreign-policy issues—on which the centrist Radicals usually side with the parties of the left, giving them a majority.

But although it looks as if that majority will continue to exist in the Folketing, it is too soon to start numbering the days of Denmark's NATO membership. The Social Democratic leader, Mr Auken, says that, whether he becomes prime minister or remains in opposition, he and his party will ensure that the resolution of April 14th is implemented in a way that will make it compatible with the neither-confirm-nor-deny policy of Denmark's allies.

If Mr Auken is as good as his word, this election could prove to have been much ado about nothing much. He is likely to have to keep his promise from a seat on the opposition benches. The election will probably leave intact both the left-centre majority on foreign policy and the right-centre majority (again including the Radicals) that supports Mr Schlüter on domestic policy and has kept him in office for six years. Yet margins are small in the nine-party Folketing, and nothing astonishes in Danish politics.

France

Three go free

FROM OUR PARIS CORRESPONDENT

FOUR days before the presidential election on May 8th which almost everybody was expecting him to lose, France's prime minister, Mr Jacques Chirac, played what he hoped was a trump. To jubilant supporters at a Wednesday evening rally in Strasbourg he announced the release of the remaining three Frenchmen held captive in Lebanon. The same day 23 gendarmes held by separatist rebels in the French territory of New Caledonia were freed by French soldiers at the cost of more than a dozen lives. But what was the price of getting the Frenchmen out of Lebanon?

The French official who has been in closest touch with Iranians in Tehran and Shia Muslims in Lebanon is Mr Jean-Charles Marchiani, an adviser of France's interior minister, Mr Charles Pasqua. The two men, old friends and fellow-Corsicans, helped to arrange the release last summer of two French hostages and the ending of Iranian and French embassy sieges in the two countries' capitals. In the process an Iranian

suspected by French intelligence officials of helping to organise terror-bombings in France went free.

Neither the prime minister nor Mr Pasqua was ready to say on Wednesday what price if any had been paid for the latest release of hostages. In return for their help in getting the hostages back, the Iranians have over time made various demands. One is for France to ship arms to Iran again, and to sell Iraq fewer. No arms for Iran and continued shipments to Iraq is France's official line. The Iranians want, second, to restore diplomatic relations, broken off during the embassy sieges last summer. Third, they have asked for the repayment with interest of the final slice of a \$1-billion Iranian loan to a state-owned French nuclear company.

The other Iranian demand was for the release from French prison of three men, including Mr Anis Naccache. Mr Naccache was convicted of trying in 1980 to kill Mr Shahpur Bakhtiar, the Shah's last prime minister, then in exile in Paris. Commuting their long sentences would mean a request for clemency by the prime minister (whoever he is after Sunday) to the president, who has the power of pardon under the constitution. Mr Mitterrand said last year that he would not even consider clemency until

all France's captives in Lebanon were free.

Getting hostages free in Lebanon, many say, costs ready money. Rumours have been circulating for weeks in Paris that the release of the three Frenchmen was no exception. Although freeing the hostages is obviously popular in France, it will bring complaints about dealing with terrorists (and cynical shrugs from many voters about the timing). But how many governments can with a clear conscience roundly criticise France?

Turkey Street cries

FROM OUR ANKARA CORRESPONDENT

LAST weekend, four and a half years after the generals relinquished power to Mr Turgut Ozal's civilian administration, political violence returned to Turkey's streets. 14y Day saw ugly demonstrations in Istanbul's Taksim Square, the scene of a bloody riot in 1977 that Turkey's generals still remember vividly. Truncheon-swinging police charged first at the hundreds of workers who had defied the banning of their assembly, and then at the militant students who later converged on the scene. Smaller but comparable incidents were reported in other cities, and unrest has also erupted again on the campuses.

Inevitably, comparisons have been made with the grim days that preceded the 1980 military coup. At present the violence is nothing like as bad as that. Nevertheless, President Kenan Evren said on April 30th that, if the bad old days did return, the army might have to intervene again. His speech earned him unrestrained criticism from the opposition parties, and particularly from Mr Suleyman Demirel, the prime minister the army deposed in 1980. In response, the president has reaffirmed his commitment to democracy; but his warning lingers in the minds of many Turks.

Mr Ozal is now entering probably the most testing period of his career. Things have not gone well for him recently. Inflation is still rampant (last year's rate was around 70%). The opinion polls suggest that, for the first time, his Motherland party is now trailing behind both the Social Democrats and Mr Demirel's True Path party. Mr Ozal's ministers have been booed at meetings in many parts of the country. To crown it all, his bid to make things up with Greece has run into serious trouble.

Wisely or unwisely, the Greeks now seem determined to make Turkish concessions over Cyprus a prerequisite of further improvement in their relationship with Turkey. Last week they emphasised this by insisting on raising the question of Cyprus at an EEC meeting in Luxembourg. Anti-Greek feeling has surfaced again in Ankara, making it virtually impossible for the vulnerable Mr Ozal to offer the Greeks the concessions (such as a withdrawal of some of Turkey's troops in Cyprus) that they are

Weightlifter diplomacy

AN IMPROBABLE Balkans summit took place last week in, of all places, Cardiff, in south Wales. It was between the presidents of the Bulgarian and Turkish weightlifting federations. They indeed had weighty business to discuss: a likely Olympic gold medal and the troubled relations between Bulgaria and Turkey. This bout of sporting diplomacy was prompted by the appearance in the European weightlifting championship of Mr Naim Suleymanoglu of Turkey, formerly Mr Naum Shalamanov of Bulgaria.

Mr Suleymanoglu, who is widely regarded as the best lifter ever, defected from Bulgaria to Turkey in December 1986. He said that he had decided to defect the previous year when the Bulgarian authorities forced him—along with thousands of other ethnic Turks—to Bulgarianise his name from Suleimanov to Shalamanov. He vanished while representing Bulgaria in Australia, and re-emerged a few days later in Ankara, where he was welcomed as a hero and promptly given Turkish citizenship.

His defection stunned Bulgarians, for whom weightlifting is a national passion. The Bulgarian government at first claimed that he had been abducted by Turkish agents. It was then further embarrassed when Mr Suleymanoglu (alias Shalamanov, alias Suleimanov) spoke to the press about the brutal treatment of Muslims in Bulgaria.

According to the International

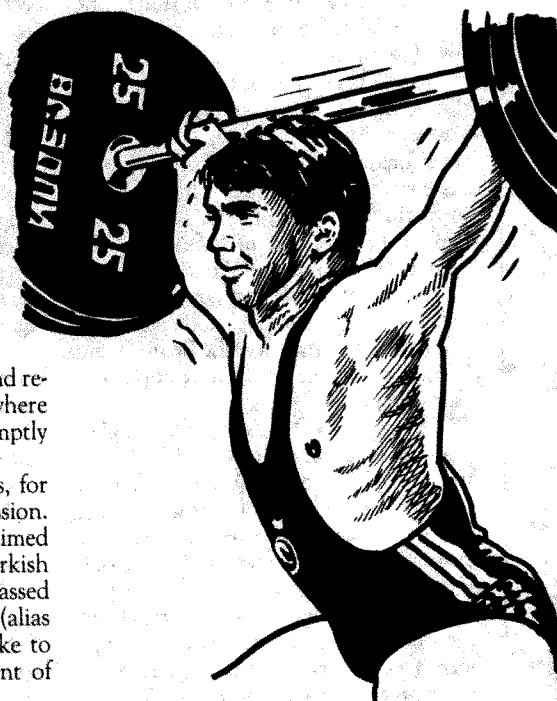
Weightlifting Federation's regulations he became eligible to lift for Turkey in December. He reappeared in Cardiff last week and duly triumphed with three gold medals and a mighty new world record. He dedicated his world record and his gold medals—the first ever won by Turkey in the 66-year history of the European championship—to his family and fans in both Bulgaria and Turkey, and addressed

an impassioned plea to the Bulgarian authorities to allow his family to join him in Turkey.

Now for the Balkan diplomacy. To the chagrin of the Turks, their new hero is not eligible to lift for Turkey in the Seoul Olympics unless the Bulgarians agree. According to the Olympic rules, an athlete cannot compete for his adopted country in the Olympics for three years after the move, unless the two national Olympic committees agree to waive the ban.

So Bulgarian politicians can decide between revenge and something more subtle. They could take the opportunity to mend relations with Turkey, which have been strained ever since the name-changing scandal. They could also extract a lot of money. The Turkish press has been full of rumours that the Turks had agreed to pay \$1m to the Bulgarians for Mr Suleymanoglu's passport to the Seoul Olympics. One senior Turkish official says that Turkey is willing to make "any sacrifice" for Mr Suleymanoglu to go to Seoul.

Mr Suleymanoglu has agreed to write a letter to the president of the Bulgarian Weightlifting Federation asking permission to lift for Turkey in the Olympics. The next stage of this Balkan diplomacy will be more talks between the respective federations in Sofia. How will the Bulgarians use their new-found muscle?



Seoul-searching Mr Alias

EUROPE

demanding. He would love a foreign-policy success that would divert attention from his troubles at home. Until last week he hoped the rapprochement with Greece was going to provide it.

Yet Mr Ozal's habitual confidence has not deserted him. He reckons the new squabble with Greece will be solved when he visits Athens in June, and that on the domestic front inflation will be brought down to an acceptable level within a year. Above all he is convinced that, whatever the opinion polls may say, none of the opposition parties has a credible programme with which to win the next election.

Belgium

Tongue-twisters

FROM OUR BRUSSELS CORRESPONDENT

NEARLY five months after their general election, the Belgians almost have a government. Belgian coalitions are frail at the best of times, and the one being put together by the two Christian Democratic parties (one for Dutch-speakers in Flanders, and one for French-speakers in Wallonia) and the two Socialist parties (ditto), with a little help from the Flemish nationalists, is given scant chance of surviving for long.

Even before the five parties signed a preliminary agreement on May 2nd, the agreement suffered the blow of being disowned by Mr José Happart. Mr Happart was at the centre of the (to outsiders) trivial dispute which brought down Mr Wilfried Martens and his centre-right coalition last October. The government fell because the Flemish-speaking and French-speaking parties in it could not agree whether Mr Happart, the French-speaking mayor of a rural commune

in Flanders, should be sacked for refusing to sit a test of his Dutch, the official language in Flanders.

The French-speaking Socialists gave full support to Mr Happart, which led to their good showing in December's election. Now they have ended up by endorsing the Flemish position on the recalcitrant mayor: he is out unless he sits his Dutch test. Mr Happart says he has been betrayed by the Socialists. He is not the only person unhappy with the deal. It caused a deep split, only partly patched up since, within the French-speaking Socialist party.

Why did the party change its mind? In exchange for annoying Mr Happart, French-speaking Socialists and Christian Democrats have obtained several concessions from the Flemings. One concession will provide more linguistic liberty for individuals living in mixed-language areas, such as Mr Happart's commune—except if the individual happens to be mayor.

Another concession opens the way for mainly French-speaking Brussels to become

a fully-fledged region of its own, like Flanders and Wallonia. This had been blocked by Flemings, unwilling to see two out of the country's three regions in the hands of French-speakers, who make up less than 43% of the population. On the other hand the 150,000 or so French-speakers living in Flemish suburbs around the capital will now have to vote for Flemish candidates, and not French-speaking ones as previously, in local elections.

The success of the coalition negotiations is largely due to the tenacity of Mr Jean-Luc Dehaene, a former social affairs minister who was named prime minister-designate by King Baudouin last February. But he is not going to lead the coalition. The new prime minister is none other than the outgoing prime minister, Mr Wilfried Martens. After the December election he vowed he would not head a centre-left coalition with the Socialists. But many people have changed their minds on many things since then, so why shouldn't he?

Too many princes spoil the froth

FROM OUR BRUSSELS CORRESPONDENT

MR OTTO HABSBURG'S forebears ruled large chunks of Europe, including, for a time, Spain. As a member of the European Parliament, the son of the last Austro-Hungarian emperor still keeps a kindly eye on some of the old Habsburg lands—and on some even more obscure corners of Europe. The latest concern of Mr Habsburg, who is now a West German citizen, is the status of Spanish workers in Andorra.

Some may question whether Andorra, one of Europe's ancient micro-states, needs a Habsburg touch. It already has (and has had for 700 years) two "co-princes". One is the bishop of Urgel in Spain; the other, today, is the president of France, heir to a job originally held by the counts of Foix. Although there is now an elected government of sorts in the Pyrenean valley, the co-princes—or, in practice, the Spanish and French governments—retain important blocking powers.

Tiny Andorra (190 square miles, population around 40,000), which survives by plying 8m visitors a year with duty-free goodies, is not part of the EEC, and it wants to negotiate a free-trade or customs-union agreement with the Community. Until recently it had been prevented from doing so by the co-princes (or their governments), who did not want to complicate the difficult negotiations on Spain's entry into the Community. But it is now more than two years

since Spain joined the EEC.

The Govern (as Andorra's ruling body is called in the local language, Catalan) thinks an agreement would make it attractive for foreign investors to use Andorra as a manufacturing base for the EEC market. It has just written to the president of the European Commission, Mr Jacques Delors, asking for a meeting to prepare negotiations. But neither of the co-princes is keen to enhance Andorra's role as a source of cheap consumer goods. This is particularly true of Spain, whence two-thirds of Andorra's bargain-hunters come. Mr Felipe Gonzalez's Socialist government argues that Andorra ought to introduce adequate labour and social-security laws before it gets a trade agreement with the EEC. More than 20,000 Spaniards work in Andorra, mainly in tourism.

Spain has received unexpected support from Mr Habsburg, as leader of a group of members of the European Parliament who have presented a draft resolution linking any trade deal with Andorra to the introduction of trade-union rights there. Although Mr Habsburg himself is sometimes regarded as a bit of an anachronism, this could matter. The parliament recently used the extra powers given it by last year's revision of the Treaty of Rome to block a new trade agreement with Israel, because of its displeasure over the Israelis' actions in the West Bank and Gaza. Now for Andorra.

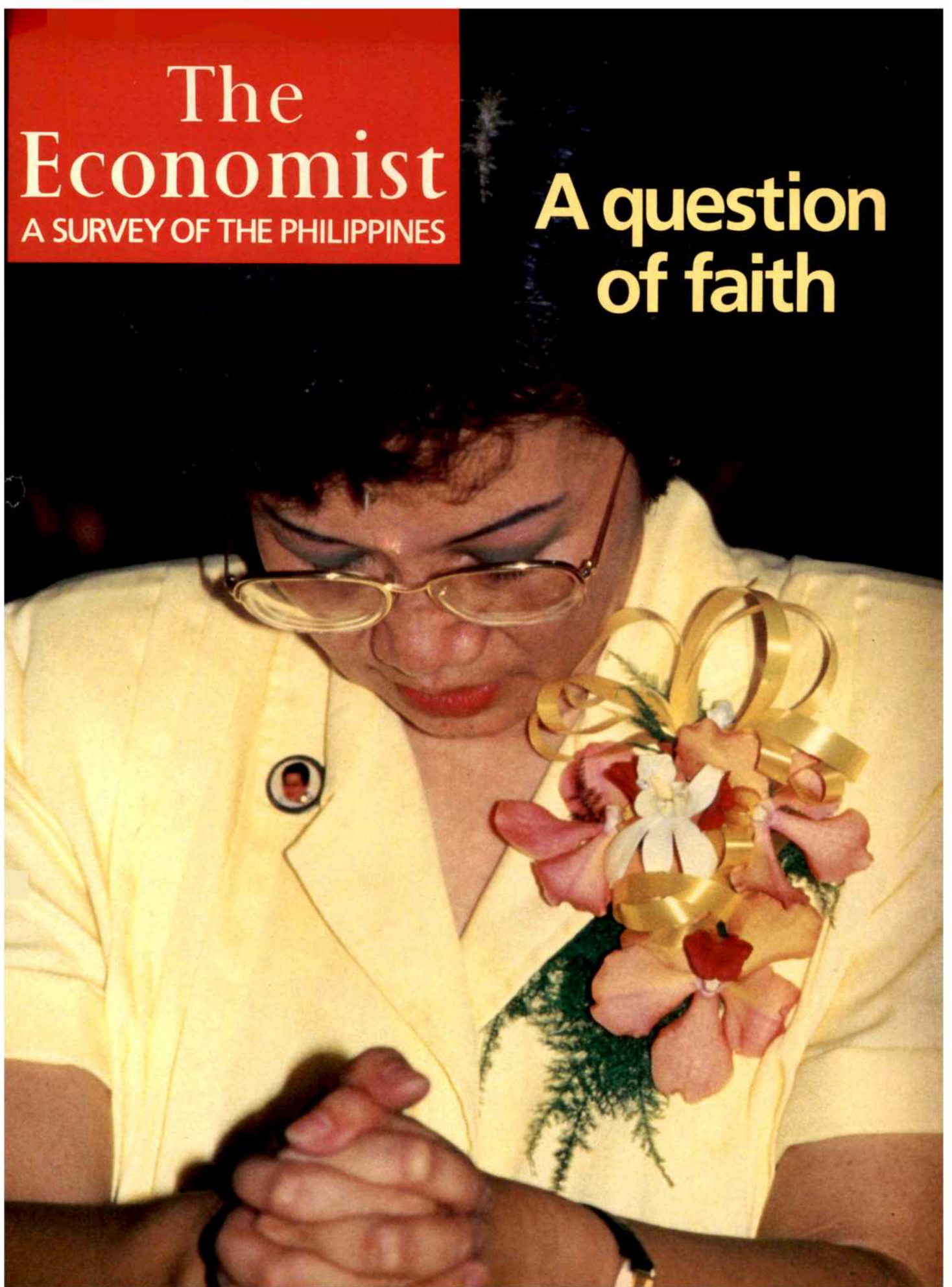


Martens puts left foot forward

The Economist

A SURVEY OF THE PHILIPPINES

A question of faith



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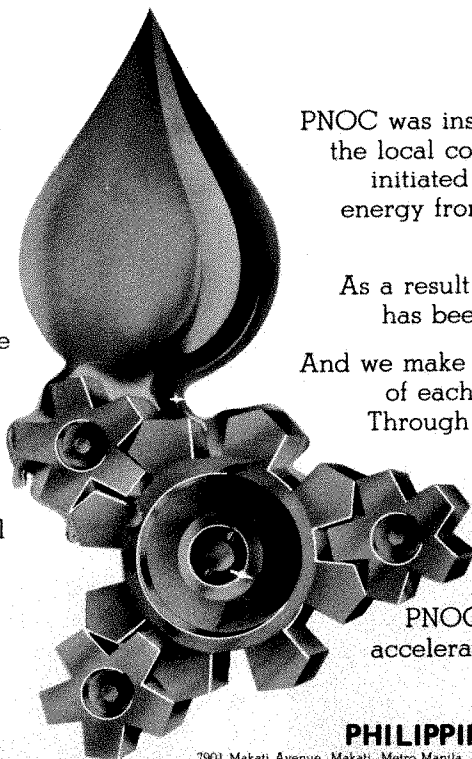
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THE PHILIPPINES



A question of faith

IT IS hard to take the Philippines seriously. Loyal soldiers play pop records to persuade rebel colleagues to surrender. Communist insurgents sell safe-conduct passes to anti-communist politicians. The new customs chief, determined to root out corruption, says his men may accept gratuities. Both rich and poor carry ridiculous nicknames, like Bong Bong (the son of former President Marcos), Ting Ting, Boy and Ballsy. Mrs Imelda Marcos had a pair of disco-shoes with rechargeable lights in the heels. The daughter of the present president is trying to be a pop star. One guidebook neatly sums up the colonial experience—first Spanish, then American—as “four hundred years in a convent, followed by fifty in Hollywood.”

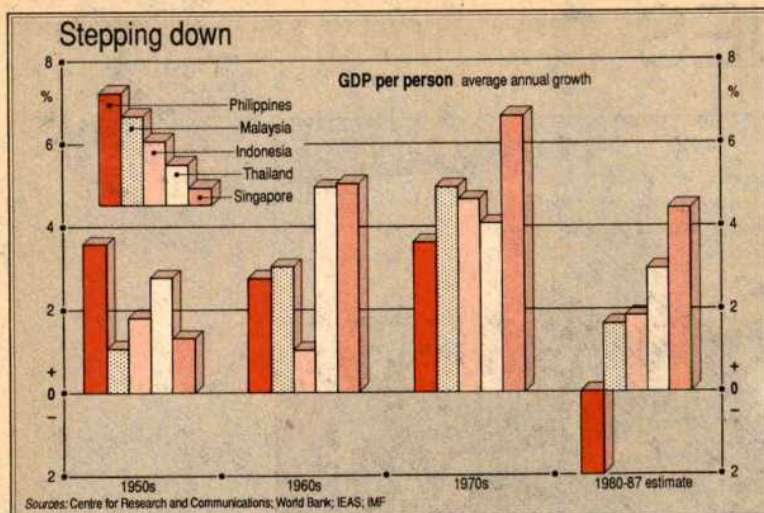
But the Philippines is more than a long-running foreign sit-com whose characters conveniently speak American with a Latin twang. Just over two years ago, on February 25 1986, the massed demonstration of “people power” at EDSA—the capital’s arterial highway of Epifanio De Los Santos Avenue—forced President Ferdinand Marcos to flee Malacañang palace first by American helicopter to America’s Clark air base, north of the capital, and then by military airlift to a humbling exile in Hawaii. A dictator whose supporters included President Reagan had been overthrown, almost without bloodshed. Left behind were dialysis machines and nappies in the ailing president’s bedroom; ornate Ouija tables with their baleful hint of the occult;

thousands of Mrs Marcos’s gowns, shoes and furs. So hurried was their escape that the family’s supper was left half-eaten on the table. The new regime of Mrs Corazon Aquino, “Cory” to friend and foe alike, threw open the gates of Malacañang for all to see the excesses of Bong Bong’s father.

Those were heady days. Toppling the Shah of Iran may have come seven years earlier, but for East Asia this was a first. The Filipinos, so often derided by their neighbours as disorganised wastrels, were setting a democratic pace for others to follow. What is more, television viewers around the world could witness their courage. Without EDSA would there have been a change of regime in South Korea or a liberal lightening in Taiwan? Filipinos are entitled to exalt EDSA as a modern miracle (it is said that from the air the black-haired crowds at EDSA’s intersections looked like giant black crucifixes). Worldly foreigners, let alone sentimental Filipinos, are tempted to view Mrs Aquino as a kind of saint.

Unfortunately, sustained miracles of politics and economics depend on more than just four days of street protest, however heroic. It is wrong to characterise the benefits of the EDSA revolution as imaginary. Mrs Aquino has brought real democracy back to the Philippines. The people have voted, enthusiastically, for a new constitution, Congress and local government. Although the Communist party of the Philippines (CPP) is banned, its voice is heard through legal pseudonyms. And the cheerfully un-

Filipinos have fallen from grace. Once they were among Asia’s richest; now they are among the poorest. They deserve better. But, argues John Andrews, they will achieve it only when they believe less in miracles and more in the mundane



inhibited press excoriates all and sundry with scarcely a nod at the law of libel or the need to check facts.

Some people expected much more from their "people power". They wanted an end to a commu-

Historical preference

*The Philippines
has its chosen
few*

MOST developing countries encourage a sense of their uniqueness. Nationalism, patriotism, chauvinism: all play their part in exorcising memories of colonial inferiority. Some countries, like Singapore, speak explicitly of "nation building"; others—for example, Arab countries—stress a golden age which may yet return.

The Philippines is different. True, there is a sense of national identity. Newspaper columnists (dozens of them, each capable of churning out a couple of thousand entertaining words a day) deplore the way foreigners, be they American multinationals or Australian sex-seekers, exploit brave but innocent Filipinos. Senators and congressmen rail against America's bases as an affront to Philippine independence. Taxi-drivers and shop assistants say Cory should now let Marcos return "because he is a Filipino".

But the sense of nationhood is a tide moved by external forces. Television, radio and the ubiquitous pop music are Americanised, or anyway westernised. Over 400,000 Filipinos work overseas; thousands more would like to join them. Bar girls dream of finding an "Americano" husband to transport them "stateside". Even cabinet members cherish green cards that permit work and residence in the United States. Objectively, it is a national tragedy: each woman who goes as a maid to Hong-kong or as an "entertainer" to Japan, each man who goes as a crane driver to Saudi Arabia represents a family broken for two, three or more years. But those involved react subjectively—the lure of foreign wealth and sophistication is a powerful antidote to heartbreak, and a stint abroad confirms the belief that foreign is better than Filipino.

Does it matter? The answer must be yes. Resource-poor Taiwan, South Korea and Singapore

have all prospered through will-power and hard work. Just think what the Philippines, so blessed with natural resources, might have achieved with even a modicum of national discipline and cohesion. Instead, a country which 30 years ago was arguably Asia's richest after Japan is now almost as poor as Indonesia.

Who is to blame? Filipinos, uniformly devout in Asia's only Christian country, will attribute respon-

nist insurgency that has now lasted for 19 years; a change from the corruption of the Marcos era; instant prosperity in contrast to the belt-tightened poverty of the mid-1980s. They have been disappointed. The economy is undoubtedly improving, but three-fifths of the 56m Filipinos live beneath a poverty line that is officially set at around \$120 a month for a family of six. Even optimists say that real income per head will not reach its 1981 peak until perhaps 1991.

In terms that are real to people, as opposed to economists, this adds up to what a well-fed visitor might call misery. Manila, already gagging on its own waste and pollution, is a tawdry magnet for the rural poor. Families live in the open; young women learn to sell their bodies; scavenging through the garbage heaps is a full-time occupation. Even college graduates scramble to find jobs abroad as domestic servants. And yet few Filipinos look miserable. Most still have faith in Cory; prefer God to Marx; and accept their lot with an innate tolerance. True, there have been at least five coup attempts against Mrs Aquino's government, but they have failed. Before predicting more, alarmists should remember the cultural preference for the status quo.



Shall I go?

sibility to God, the Americans and the Spanish. In all cases, they are right. Divine decree has sprinkled the Philippines over a typhoon-prone Pacific archipelago of around 7,100 islands. Anthropologists claim there are 111 different cultural and racial groups speaking some 70 different languages, from Muslim Malays in the southern islands of Sulu to Episcopalian Igorots in the Cordillera mountains of Luzon. Nobody would pretend it is a promising recipe for a sense of national integrity.

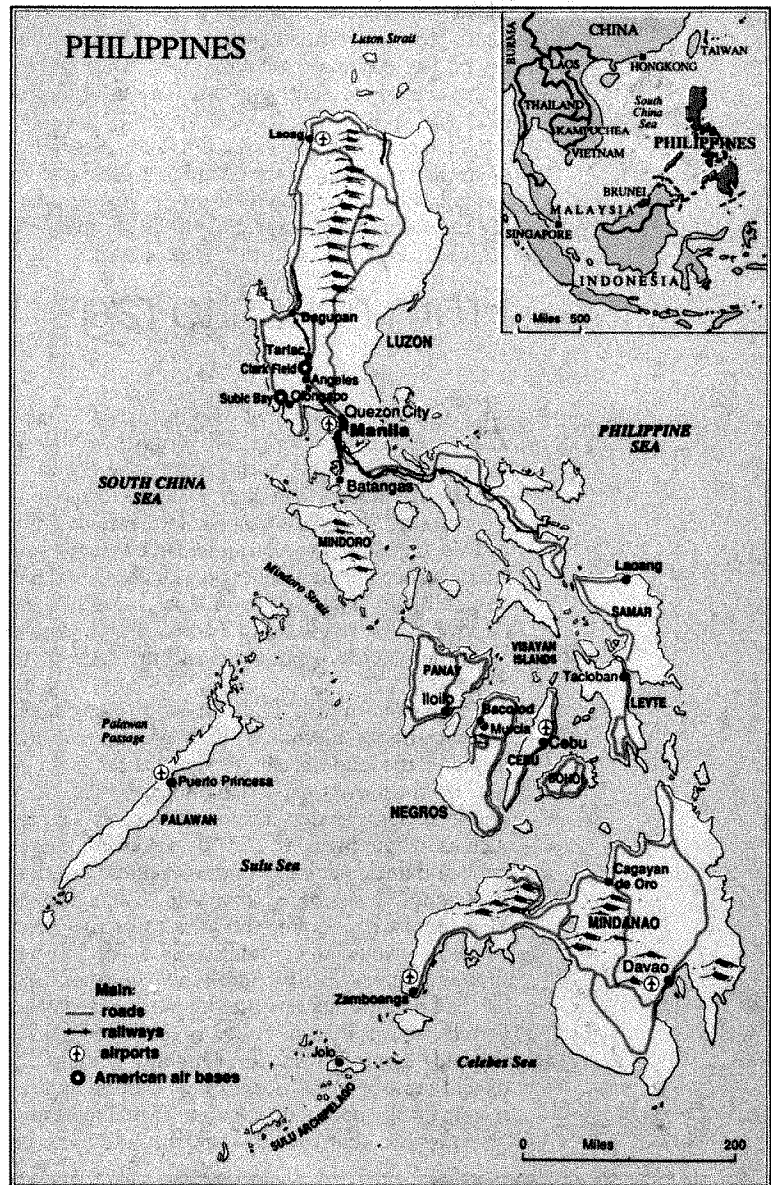
What makes it still less promising is the country's nuances of class and colour. "Filipinos" exist only as a definition of citizenship. Reality is a brown-skinned peasantry of Malay origins and an elite whose skins have the lighter hues of Spain and China. Filipinos are too friendly to be bigots, and the melting pot of history—Chinese traders and Spanish soldiers needed local wives or concubines—rules out fantasies of ethnic purity. But all Filipinos are aware of their place in the spectrum: peasant women whiten their faces before going to a dance; and in last year's campaign for the Senate the high-born candidates would publicly apologise for suntans caught on the hustings.

The phenomenon is not unique to the Philippines. There are, for example, parallels in Brazil and Venezuela. Nor should the impact on individuals be exaggerated. It is probably easier being a brown, Malay-faced Filipino than being an American black. But the harm is in the implied social rigidity. The Philippines, despite almost a century of democratic institutions, remains a feudal society. The top one-fifth of the population receives half the country's income. Famous family names—Lopez, Laurel, Romulo, Soriano, Zobel, Cojuangco, Ayala, Aquino—crop up constantly in the arenas of power, both political and financial. Too often, the name, not the policy, is the key to success. One academic claims the economy is effectively controlled by a mere 60 families.

A matter of birth

Blame both Spain and America. The former, in over three centuries of colonisation, created the Philippines' elite; the latter, in an occupation lasting from 1898 until 1946 (with an unkind Japanese interruption from 1941 to 1945), preserved it. At the top came the *mestizos*: those whose blood was "mixed". The best *mestizos* had mainly Spanish blood, with just a dash of *indio*—or native—genes. The next best were Chinese *mestizos*. Both groups prospered. They leased land from the Catholic friars and sublet it to the *indios*. They gained still more land because the law limited an *indio*'s debt to just 25 pesos. The *indio* would evade the law by selling his land to the *mestizo* with the right to repurchase it later. It was an early form of loan-sharking; invariably the *indio* failed to find new money with which to repurchase his land.

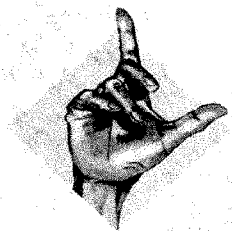
And so the fair-skinned *mestizos* became rich. The lines between Chinese and Spanish blood were blurred into a more-or-less single aristocracy as the Chinese hispanicised their names (the syllables of the Aquino name and the president's own Cojuangco clan tell the tale). By the end of the nineteenth century the top educated families were the *ilustrados*—the "enlightened" who would lead the fight for independence against a selfish Spain. In



the event, they were pre-empted by America, which had gone to war with Spain over Cuba. America's victory meant Spain's surrender of not just Puerto Rico but also Guam and the Philippines. In the process, the *ilustrados* were co-opted by an America which could not quite admit to building an empire. Instead, America, with a patronising concern for its "little brown brother", would help the Philippine elite turn the country into a "showcase of democracy".

The concept has a soothing logic. Why not enlist the favoured few in the evolution of a system that will help the less fortunate? But there is a flaw beneath this veneer. Democracy is based on the will of the majority; by definition, the elite is a minority. And the Philippine elite, like any other, is hardly likely to surrender its privileges voluntarily. Indeed, hardly any criticism today attaches to the Laurel family for collaborating with the Japanese: they and others were preserving the continuity of Philippine leadership "in the interests of the people".

So when does this flaw become a serious social irritant? Feudal subservience, deep religious faith, a





Malay deference to authority and a Spanish tendency to procrastinate—all these are powerful salves. But the itches are also strong: an impoverished, landless peasantry; an ostentatiously wealthy oligarchy.

That combination, with China's Maoists acting as an example, spurred the communist Hukbalahap guerrilla movement, which fought the Japanese during the second world war and the newly indepen-

dent Philippine government after it. The Huks were beaten in the early 1950s by a combination of military force and civilian incentives. Both were administered by Ramon Magsaysay, a president unique in the Philippines for his humble origins and honesty. Unhappily, Magsaysay died in an air crash in 1957. Even more unhappily, his successors have squandered the opportunity he created for good government.

From riches to rags

Corruption and cronyism in the Marcos era

A TOUR of Malacañang is an instructive experience. The paintings of Ferdinand Marcos show him as a young, virile Adam; the beautiful Imelda, like a Botticelli Venus, is shown rising from a conch shell. The photographs of the president are by Miss Gina Lollobrigida, an Italian cinematic sex-kitten turned talented camera-person. Mr Marcos is in his 60s, but, naked to the waist, he displays a muscled torso that would make a boxer proud. Would any other country's president and first lady be so displayed?

Somehow, in the Philippines, it seems quite normal. Being macho is part of the culture. Jeepneys, the long-wheelbase jeeps that act as transport for the masses, carry stallion figurines on their bonnets; their fenders insouciantly carry slogans such as "virgin breaker" and "dream lover". Ferdinand and Imelda did not contradict cultural norms: they simply exaggerated them. Imelda, a former Miss Manila contestant who grew to be the "iron butterfly", would spend millions of dollars on her shopping sprees. Her perfumes came in gallon jars; her ball dresses came by the dozen. But she called herself "an inspiration" to the poor. "They need", she said, "a star to reach for. I am both a star and a slave. I must be a star, something beautiful and inspiring for the poor to reach up to. And I must also be a slave, so that everybody in the gutter can be

lifted up, by my work and my example, to be a star, too." Millions believed such piffle; thousands still do today.

The president—FM as the headlines now call him—did more than exaggerate. He invented. Government publications during his presidency said he was the most decorated Filipino soldier in the second world war, with between 28 and 34 (the number varied) medals. The president of the Philippines not only looked macho, he was. Yet the war record of this "guerrilla fighter against the Japanese" is almost entirely a work of fiction. There are no witnesses or contemporary records to confirm Mr Marcos as a Pacific version of Audie Murphy. That the lies were widely accepted for so long says something vaguely depressing about the Filipino tendency to prefer appearance to substance.

The irony is that Mr Marcos had no need to embellish his reputation. In a nation where lawyers enjoy ludicrous esteem, he graduated first (the "top-notcher") from the Philippines Law School. Even before being licensed to practise, he made his mark. At the age of 22 he defended himself before the Supreme Court against a murder charge (he had allegedly shot dead a political rival of his father). He won, with Justice (later President) Jose Laurel saying that "to send this young man to jail would be to deny the country a brilliant lawyer".

The country was not denied. In 1949, at the age of 32, he entered the House of Representatives; by 1959 he was in the Senate; by 1965 he was president. Mr Marcos, it seemed, would take the Philippines into a golden age after the corrupt, lack-lustre presidency of Diosdado Macapagal. The omens were promising. The Philippines possessed natural resources—timber, coconut, sugar, bananas, rubber, minerals—in enviable abundance. In the 1950s its manufacturing output had grown by 12% a year in real terms, making it the most developed nation in South-East Asia. With the help of technocrat advisers, the dynamic young president would reduce corruption, increase tax revenues, get more rice grown and provide more roads, schools and hospitals.

Spoiling the dream

Yet today corruption remains pervasive; the roads are crumbling; and the peasants are among Asia's poorest. Something went badly wrong with the high hopes and the noble plans.

The fashionable culprit is, of course, Mr Marcos. And rightly so, since his bright beginning deteriorated into political repression—martial law was



The deposed



Scavengers

declared in 1972—and spectacular corruption. But perhaps even a scrupulously honest politician, rare enough in the Philippines, would have failed. Arguably, Mr Marcos's leadership merely hastened an economic momentum that was always heading in the wrong direction.

The Philippines' problem was one of strategy. In the 1950s its planners embraced the development concept of the day: industrialise by import substitution. The idea seems sensible enough, since it apparently saves foreign exchange, creates employment and upgrades skills. And, for a time, it worked. The Philippines' real GDP per head grew by 3.6% a year in the 1950s; in contrast, Singapore's grew each year by 1.3%, Malaysia's by 1%, Indonesia's by 1.9% and Thailand's by 2.8%. In short, the Philippines had a head start on rivals who would all soon adopt the same strategy. The Philippines, however, made two mistakes. Like Indonesia, the country failed to build export-oriented industries based on its import-substituting factories. And, unlike Taiwan, South Korea and Thailand, the Philippines failed to develop agricultural productivity.

The result was a country living under an illusion of prosperity. By the end of the 1960s the Philippines was the slowest growing economy in non-communist South-East Asia. Imported food, consumer goods and raw materials for industrial processing were paid for by exports of agricultural commodities like timber, sugar and coconut. These exports increased in volume not because the landowners extracted higher yields from their land, but because they increased the land under cultivation. Meanwhile, industry, in the name of the national interest (and in the pursuit of individual self-interest), was protected from foreign competition. Mr Bernardo Villegas, probably the Philippines' best-known economist, reckons that as late as 1979, when the mistakes had long been obvious, industry enjoyed tariff protection of 36%, compared with a regional average of under 10%. The product of this folly was

a country spending beyond its means and blind to its own blatant inefficiencies.

All true, alas. Yet plenty of countries make similar mistakes and somehow, like Indonesia, survive. Sovereign countries, after all, do not go bankrupt in the way that companies do; and the Philippines had the added political bargaining power of Clark air base and Subic Bay, America's most valuable military facilities in Asia.

The ruin of the Philippines in the Marcos era has to have more specific causes. One is the oil-price shocks of the 1970s. The country's oil-import bill rose from \$187m in 1972 to \$651m in 1974 and \$2.5 billion in 1980. But that strain alone could not have ripped the economic fabric apart, since the rest of the oil-importing world coped with the same crisis (and, in fact, the Philippines reacted remarkably well). Another obvious candidate is the pressure of population. When Mr Marcos became president there were around 38m Filipinos; by 1983 they numbered 50m, and the number living below the poverty line had doubled to 35m.

Such problems would have taxed any Philippine leader. But Mr Marcos compounded them with a political style that became ever more corrupt. In 1972 the fates were conspiring against the president (he had been re-elected in 1969). The economy was worsening; monsoons wiped out the rice crop; the communist insurgency was growing. The president's solution was one that appeals to many a beleaguered leader: authoritarian rule to enforce discipline and end such inconveniences as a political opposition and student protests. The excuse was an ambush on the car of the defence secretary, Mr Juan ("Johnny") Ponce Enrile, on the night of September 22 1972. Typically, it was a trick. Mr Enrile now admits that the incident was staged. But it served its purpose. The next day Mr Marcos announced martial law and the birth of a "New Society".

The road to ruin

Many wished the experiment well. The detention of opposition politicians such as Senator Benigno ("Ninoy") Aquino and of journalists and trade unionists; the closing of newspapers and radio stations; the presidential decrees curtailing civil liberties; the promulgation in 1973 of a new constitution to extend the president's rule—all might have been forgiven by people with full bellies.

Perhaps in another country, another culture, this "constitutional authoritarianism" would have worked. A land-reform programme (the "cornerstone of the New Society") was announced to distribute all rice and corn holdings above seven hectares to landless peasants in the form of family-sized farms (three hectares if the land was irrigated, five if it was not). Infrastructure projects primed the economy to grow by 10% in 1973, and by 5-6% in 1974-75 despite the tripling of oil bills. By 1977 the Masagana 99 programme, with cheap credits for fertiliser, gave the country self-sufficiency in rice. Belatedly, the Philippines developed "non-traditional" exports, such as shoes, electrical components, garments and processed food. In 1970 these had constituted less than 10% of total exports; by 1975 the proportion was 23% and by 1983 58%.

But the experiment did not work. Its author corrupted it through nepotism and what is now





The beginning of a legend

known as "crony capitalism". While the country mortgaged its future (foreign debt rose from \$2.6 billion in 1975 to \$10.5 billion in 1980 and \$26 billion in 1984), the relatives and friends of the first couple became grotesquely rich. Benjamin ("Kokoy") Romualdez and Alfredo ("Bejo") Romualdez, both brothers of Mrs Marcos, became wide-ranging business barons. Mr Eduardo ("Danding") Cojuangco, the estranged cousin of Mrs Aquino, took charge of Unicom, a monopoly set up to administer coconut exports. Mr Roberto Benedicto controlled the National Sugar Trading Corporation and so determined the price and quantity of the country's sugar exports. There were other cronies, all indebted to the president and the first lady—who received a "slice of the action" for their patronage.

Through presidential decrees and hidden stockmarket manipulations the cronies and the relatives became a new oligarchy. Unlike their counterparts in other developing countries, such as Indonesia or Taiwan, they did not invest their good fortune at home; they put it to selfish use abroad. They were, in effect, robbing a whole nation. And if there were objections, they could always be solved by the traditional Philippine weapons of "guns, goons and gold".

Just how much was siphoned off, and into which foreign bank accounts and real estate, will probably never be properly known. The Presidential Commission on Good Government, set up by Mrs Aquino to recover "all ill-gotten wealth" accumulated by the Marcos family and friends, talks in terms of over \$10 billion. It would have been still more had someone—almost certainly acting under the orders of the military—not assassinated Benigno Aquino on August 21 1983 as he stepped out of an airliner that had just brought him home from exile in America.

Death not in vain

The shot was doubtless meant to protect the regime. Aquino's reputation had grown first during his eight years' imprisonment, then during his three years in America. Free to speak in a Philippines that again pretended to democracy (martial law had been lifted in 1981), he would have been a rallying point

for an opposition that had been cowed for too long. The paradox is that Aquino's death sealed the fate of Mr Marcos far more effectively than Aquino's speechmaking might have done.

With hindsight, the reason is logical enough. The regime had already stretched the economy to tearing point through corruption and mismanagement. The current account in 1982 had been in deficit by a record \$3.2 billion and was only marginally improving; the exchange rate was collapsing; and inflation was soaring. The hope was that the American economy would boom in time to give the Philippines an echo. Instead, Aquino's killing abruptly made things even worse by provoking a massive flight of capital to safer havens. By October the government had to declare a moratorium on the debt it owed to 483 foreign banks. Neither they nor the IMF were amused to find that the central bank had deliberately overstated Philippine reserves by \$600m in an attempt to improve the country's credit rating.

The predictable solution was the kind that initially bears hardest on the poor: slash government spending and tighten credit to cut demand. The current-account deficit went from almost 8% of GDP in 1983 to under 4% in 1985 and just 0.2% in 1985. Real GDP shrank by 6% in 1984 and another 4.4% in 1985. Imports fell by 16% in 1984 and another 23% the following year. The austerity hardly touched the cronies, but 400,000 workers were laid off in 1984 and under-employment rose to an estimated 36.5% of the workforce.

That sort of pain is enough to arouse even those most inured to the inequalities of feudalism—and the Filipinos this time had the added insult of Aquino's death to channel their ire. Their reaction showed first in the May 1984 elections to the National Assembly, when the opposition, backed by Aquino's widow, Cory, gained 56 out of 183 seats despite massive vote-rigging. It showed again in the votes for Mrs Aquino when Mr Marcos hoped to catch the opposition off-guard with a snap election for the presidency in February 1986. It showed finally in the "people power" determination at EDSA later that month to stop Marcos from "stealing" the election by blatant fraud. But having won back democracy, what will the Philippines do with it?

Cory's magic

"THE question you all really want to ask is: 'Can she hack it? Isn't she weak?' These are the questions that were asked by all those who have openly challenged my power, authority and resolve, and who have suffered for it. I speak of the shame-faced officers who have abandoned their followers... and the failed politicians who made the last places in the last elections and are now trying to find a backdoor to power... Well, they can forget it. Although I am a woman and physically small, I have blocked all doors to power except elections in 1992."

President Corazon Cojuangco Aquino was speaking last October at the gracious Manila Hotel to businessmen who were concerned about a sense of drift in her government. No one, even her political foes, has ever challenged her personal goodness. The issue was her ability to implement policy. The joke of the moment was to take her name in Spanish, point to the heart and say "corazon, si"; then touch the head and say "aqui, no".

The questions were not unreasonable then, and they cannot be dismissed now. By last October there had been five acknowledged coup attempts against the Aquino administration. More may come (some pessimists still maintain that a right-wing coup will pre-empt the elections due in 1992 for the next president, Congress and local government). Meanwhile, government policies such as land reform, the privatisation of state assets and the recovery of "ill-gotten" wealth are all foundering in a verbose and litigious maze that is profoundly Filipino.

Realistically, could it, can it, be otherwise? Educated and impatient Filipinos, like those businessmen gathered at the Manila Hotel, tend to make a ritual bow to Cory's goodness before declaring that what the Philippines needs is not a saint but a Lee Kuan Yew or a General Franco. Western visitors often agree. They are wrong. A culture like that of the Philippines would produce a corrupt dictator like Mr Marcos rather than an honest authoritarian like Mr Lee Kuan Yew.

Instead, perhaps the Philippines should be grateful for the leader it has. Mrs Aquino is a product of the feudal aristocracy—her father a Cojuangco, her mother a Sumulong. Her family has a huge sugar estate, Hacienda Luisita, in Tarlac, north of Manila. She and her relatives are part of the oligarchy that has ruled, and misruled, the Philippines for centuries, even during the time of the Spanish and Americans. It is virtually impossible for political reputations in that class to be immaculate. Even her dead husband, now considered a martyr, is linked by some to skulduggery and to convenient alliances with communist rebels. But Mrs Aquino is an exception, because of her sex. Mr Marcos said of Mrs Aquino, "Women should confine their preaching to the bedroom." In a macho society Cory was "an ordinary housewife", who should not meddle in politics. By the same token, she should not in Filipino eyes be blamed for her nation's ills—which helps explain the popular tolerance for the manifest inefficiencies of her government.

The problem is that over time the tolerance is likely to ebb. The president told the businessmen: "I am not sorry the honeymoon is over. The sooner we get over the fantasy of the honeymoon and face the hard work of marriage—the marriage of president and nation—the better."

In which case, Mrs Aquino is asking to be judged not by her goodness but by her deeds. It is a mixed record, not as bad as her critics allege but not as good as her hagiographers proclaim. Her obvious achievement is to have brought back real democracy. Consider what was done in just under two years: in March 1986 a "freedom constitution" was proclaimed so that Mrs Aquino could rule by decree and sweep away the corrupted constitution and political institutions of the Marcos era; in February 1987 a national plebiscite overwhelmingly approved a new, transparently democratic constitution; the following May a new Senate and House of Representatives were chosen in the first truly free elections since before martial law; and in January this year towns throughout the country elected their own local governments. For all the use—and there was much less than in the past—of guns, goons and gold, the Philippines is now indubitably being run at all levels by those chosen from and by the people. The new constitution, of painful length and complexity, limits the presidency to a single term of six years; restricts the president's powers; and guarantees human rights. A second Marcos is legally impossible.

It adds up to an immense feat: a comprehensive political system for a population bigger than Britain's in a country of islands spreading 1,100 miles from north to south. It was achieved in concert with Mrs Aquino's less obvious accomplishment: the transformation of her government from a collection of disparate, often conflicting elements into a body that now makes a convincing show of cohesion. The second accomplishment may eventually prove to be



Good intention is one thing, action another



Politics are always messy



They came and went: Enrile; Arroyo; Ongpin

more important than the first.

The president was never "an ordinary housewife". How could she be, given her background? But she was a political ingenue, susceptible to the last adviser applying pressure. Two things have protected her. One is an absolute faith in God. The other is simply her growing experience in her job. She has learned that she has power. Her first trips abroad as president were to Indonesia and Singapore, in August 1986. There, according to a confidant, "she saw people with real power, and she knew she was not like other people." Indonesia's President Suharto and Singapore's Mr Lee Kuan Yew, have shown her "the power game."

Leaning left, then right

It is a game she needed to learn. "People power" swept Cory to power on a tide of emotion, not practicality. Her first cabinet was an uncomfortable blend of human-rights lawyers, such as Joker Arroyo, Rene Saguisag and Augusto Sanchez, and technocrats such as industrialists Jaime ("Jimmy") Ongpin and Jose Concepcion. The most discomfiting ingredient was the right-wing presence of Mr Juan Ponce Enrile. It was a cabinet based on Mrs Aquino's personal debts, not on considerations of competence or ideology. The human-rights lawyers had kept faith with her husband during his worst moments; Mr Ongpin and Mr Concepcion had defied Mr Marcos and embraced the Cory cause when they had no need to; Mr Enrile, the defence minister of Mr Marcos and so the administrator of martial law, had carried "people power" to victory by turning against Mr Marcos at the crucial moment. Such a blend was a recipe inviting disaster.

The invitations have been delivered in a typically theatrical Filipino fashion. For example, in July 1986 when the former vice-president, Mr Arturo Tolentino, seized the Manila Hotel with a bunch of rebel soldiers in order to proclaim Mrs Aquino an impostor as president, the hotel worried about its room service. When the rebels surrendered, their punishment was an order to do extra press-ups. A government minister suggested that perhaps Mr Tolentino, an amiable and punctilious lawyer, should have mental treatment. Four months later, when Mrs Aquino was preparing for a trip to To-

kio, the plot against her was code-named "God Save The Queen": she would be allowed to reign as a figurehead, but Mr Enrile would rule as a powerful prime minister. The idea was so much talked about that it never had a chance of coming true.

Yet even hamfisted plotting has a pernicious, destabilising effect. The link between all the coup attempts was not just a perception of what Mr Enrile first termed the "sense of drift" but also a feeling in the armed forces that the "left-leaning" lawyers—Mr Joker Arroyo, the executive secretary, being the main culprit—were sabotaging the national fight against the communist insurgency.

Persuasive evidence could be found. Mr Ongpin, a dedicated secretary of finance, complained that the incompetence (or scheming) of Mr Arroyo was costing the state millions in delayed tax reform and aborted asset sales. The Reform the Armed Forces Movement—a group of young military officers linked to Mr Enrile and known cutely as the "Ramboys"—believed the offer of amnesty to the communist insurgents, coupled with a two-months ceasefire at the end of 1986 and peace negotiations, was politically and militarily stupid, insulting to soldiers risking their lives against the insurgents and, in effect, akin to treason.

Hence the atmosphere of constant tension which culminated last August in a coup attempt by Colonel Gregorio ("Gringo") Honasan and other Ramboys. Unlike previous attempts, this one turned bloody: more than 50 people were killed, mainly innocent civilians who had turned up to watch what some Filipinos call "showtime". No wonder foreign investors look askance at the Philippines; no wonder Mrs Aquino's speechwriters took such pains to assure the local businessmen that the drift was ended.

But two things should be borne in mind. One is that the coups failed (often comically). The other is that they did not take place against a static background. Mrs Aquino may not admire Machiavelli, but she is not without political instincts. Of her original team, only a handful now remains. The present team makes real pretensions to cohesion and efficiency and is therefore reasonably acceptable to the two groups, the military and business, who had grown most exasperated with Mrs Aquino's indecisiveness.

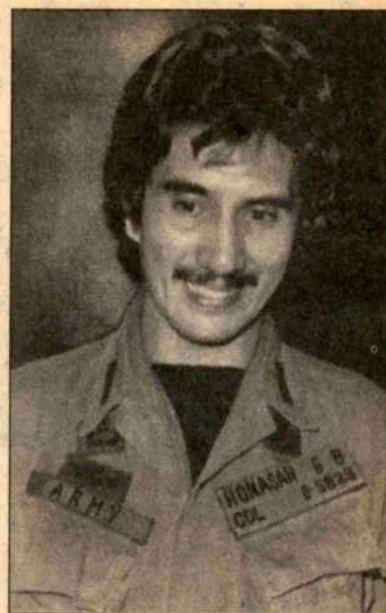
The question is whether Machiavelli would have advised her to move faster. The first big sweep through the cabinet came in November 1986: a couple of ministers were fired for corruption and incompetence; Mr Enrile was fired because his criticism of the government was becoming too embarrassing; Mr Aquilino ("Nene") Pimentel and Mr Augusto ("Bobbie") Sanchez were removed because too many thought they were too left-wing. The second sweep came with the congressional elections: ministers had to resign if they wanted to be candidates for the Senate or the House of Representatives, which meant the departure of progressives such as Mr Heherson ("Sonny") Alvarez and Mr Rene Saguisag as well as the old political warrior, Mr Neptali Gonzales.

Unfortunately, the most important change was the one longest postponed: the removal last September of Mr Arroyo. The delay shows Cory's political skills at their most frail. Mr Arroyo's combative style and administrative delay (papers would pile up unanswered on his desk for months) infuriated virtually every group he came in touch with: business, the army, the Senate, even his own colleagues. But to Mrs Aquino he was a man she could trust implicitly; he had remained loyal to her husband throughout the years of imprisonment and exile.

By relying on Mr Arroyo for so long, Mrs Aquino merely worsened the situation for which he was largely responsible. She had talked of firing him

six months before she actually did: time enough for Gringo to plot; for foreign investors to stay away; and for dedicated Filipinos like Mr Ongpin to despair (he was sacked at the same time as Mr Arroyo, and three months later committed suicide).

But if Mrs Aquino is a slow learner, at least she does learn. No longer does she believe that her sincerity alone will tempt the insurgents down from the hills. Indeed, she has moved steadily to the right—far enough in her praise of the armed forces to deny Mr Enrile political ground he once had to himself. Her administration now represents not so much human-rights activists as technocrats. The hope is that this will help place the Philippines on to a virtuous cycle: political stability will lead to economic investment, which in turn will confirm the stability and produce enough wealth for the Philippines to catch up with its neighbours. The danger is that, as Mrs Aquino's idealism fades, the Philippines will get trapped in its old cycle: feudal inequalities will feed the insurgency and so make the escape to prosperity impossible.



Showtime Gringo



Violence breeds violence

LIEUTENANT-Colonel Franco Calida, like many Filipinos, has a casual ease with guns. He usually has a handgun tucked in his belt; his bodyguards are festooned with M16 assault rifles; he complains that bullet wounds in his back (suffered last year when he was disarming a dope-smoking recruit) affect his tennis. Behind his desk there is a poster of Sylvester Stallone as Rambo. It is an image that some spick-and-span types from Sandhurst and West Point might admire, but only in secret.

But the colonel is no cowboy poseur. He is in ultimate charge of 3,000 men in Davao City, in the southern island of Mindanao. Between 1983 and 1985 hit-men from the communist New People's Army (NPA) used to kill around 800 people a year in the Davao area. In Agdao, a slum quarter on the shoreline, the killings occasionally numbered 15 a day. "We used to call it Nicaragua," says Colonel Calida. Today, killings by the NPA "sparrow gangs"—so called for their habit of flitting in and out—are almost unknown in Davao. The colonel has driven them out. In the process he has gained the praise of Mrs Aquino, and the condemnation of many churchmen and human-rights groups.

The colonel's strategy was to form a citizens' self-defence group, a polite phrase for vigilantes, called Alsa Masa (Up with the masses). It has worked for two reasons. First, the NPA was becoming increasingly unpopular as it acted more and more like an ordinary protection gang. And, second, many of the vigilantes were defectors from the NPA, including sparrows. The colonel claims that his

offer of an amnesty in the middle of 1986 attracted 22 sparrows after just four days; an ultimatum in February last year brought in 3,000 active communists and another 10,000 sympathisers. Since NPA defectors are immediate targets for assassination, the cruel fact of survival is that they can never go back to the NPA fold, which gives them all the more reason to be loyal to the colonel and to stop any NPA gunmen from infiltrating Davao. It is slightly unnerving to find that the ex-sparrow "President of the Rebel Returnees' Association" is a young-looking 22-year-old who carried out his first killing at the age of 18.

This particular ex-sparrow and his friends may all be honourable citizens, but the potential for harm is obvious. What is to stop Alsa Masa and the other vigilante groups that now imitate it from becoming government-supported extortioners? Colonel Calida's answer is to bully the government into putting up seed capital to give the defectors income-generating projects, such as piggeries or poultry farms. Meanwhile, the military (which in the Philippines includes the police force) attends seminars on human rights and becomes "people-oriented", touring the smallest precincts, or barangays, to counter the communists' propaganda.

So much for the theory. Practice in the Philippines is bound to be far from perfect. The American State Department's report on human rights notes that Alsa Masa is "overwhelmingly popular" in its areas. But human-rights groups still accuse it of going beyond permissible behaviour—and abuses are

Without peace, how can there be prosperity—and without prosperity, how can there be peace?



Bodyguard, Calida, Ramos and Rambo



certainly carried out by other groups that have taken the vigilante trail. The Tadtad ("Chop"), for example, is a fanatical cult which believes it is immune to bullets and which specialises in beheading its enemies.

One problem is that, though Filipinos are not by nature violent (public shows of anger are almost unknown), they nonetheless accept violence as a customary means of arbitration—perhaps because the corrupt wheels of formal justice grind so slowly. As Amnesty International's report on the Philippines comments: "Since the Aquino government came to power in February 1986, not a single military or police officer has been convicted of a human-rights offence committed during the Marcos administration or afterwards. In the few cases where court proceedings have been initiated, witnesses have been harassed, arrested or even killed."

The other problem is that violence on one side is matched by violence on the other. The constant complaint of the Armed Forces of the Philippines (AFP) is that they are forced to fight "with one arm tied behind our backs". The NPA and its members are not angels. Promotion often comes only by carrying out a specified killing. But officers in the Philippine army can now get promotion only if they are cleared of abuses by the constitutionally mandated Commission on Human Rights. While the NPA by definition fights outside the law, a soldier is supposed to respect a judicial code that requires a suspect to be formally charged within 6-18 hours after being taken into custody. Experience shows that even after reams of necessary paperwork, the suspect may well walk free either by astute bribery or by government amnesty. Not surprisingly, many military men, whether patrolling the mountains of Negros or the slums of Manila, prefer to take no prisoners. The new chief-of-staff of the armed-forces, General Renato de Villa, says frankly: "We have informed congressional leaders that there is a need to examine our security law. We have made them understand that it's a little difficult to face an insurgency with ordinary laws."

Unwinnable wars

The obvious question is why should different laws make any difference, since during the years of martial law, when the military had a free hand, the insurgency nonetheless went from strength to

strength. Statistics in the Philippines are not the kind to swear by, but General de Villa estimates that the NPA now has about 23,000-25,000 full- and part-time fighters and some 15,000 firearms. Another estimate gives the NPA a more believable 20,000 men. That compares alarmingly with just 39 firearms and 50 fighters in 1969.

Is the failure to crush the NPA the fault then of the AFP, which has 156,000 men, more than double its size at the start of martial law? Only in the sense that the AFP is the product of the nation. It is both poorly paid—despite a 60% pay rise pushed through late last year after Gringo's coup—and poorly equipped. Colonel Calida, for example, gets only about 6,000 pesos—roughly \$300—a month, including his allowances. Many soldiers have no boots to wear. There are not enough back-pack radios to pass on orders in the field or to mobilise helicopter support. At any one time more than half the AFP's aircraft are out of action for want of spare parts. General de Villa says with damning accuracy: "This is the poor man's armed forces."

The consolation is that the NPA is even worse off. Since an unarmed fighter is not much use, the critical factor for the NPA is how many weapons it has. In a country which regularly smuggles out shiploads of illegally cut timber, the NPA somehow manages not to smuggle in many weapons. True, almost every day there is a report of an NPA attack on a Philippine Constabulary outpost, or of sparrows killing government employees, but they are balanced by the increasingly frequent arrests of Communist party leaders. Indeed, there have been occasions when the NPA has killed its own, in panic at the success of the government agents infiltrated into its ranks.

The NPA grabs headlines. But appeals in foreign capitals for finance; talk of arms purchases abroad; the assassination, unprecedented in Philippine history, of a pro-vigilante government minister last August; the killing two months later of three Americans near the Clark air base—all add up to signs of a movement under pressure. As the Communist party of the Philippines privately admits, the NPA is not winning its war.

Nor is it really losing. Last year there were almost 3,000 violent incidents involving government forces and communist rebels: over 1,500 NPA guerrillas died, but so did almost 1,000 civilians and just over 1,000 from the military. Indeed, if the Moro National Liberation Front, seeking independence for Muslims in the south, were to open a front in Mindanao with its 6,000 or so armed fighters and at the same time the NPA were to press its attack in Luzon and the Visayas, the armed forces would clearly be under strain.

The key, however, is not so much the NPA's performance on the battlefield as its influence among the people, its "mass base" in the jargon of insurgency. The Philippines has 41,818 barangays and about 20% of them are in some way affected by the NPA. The extrapolation is that around 8m people have an awareness of communism, and that some 2m-3m form a "mass base" with real knowledge of communism and sympathy for the NPA. Any successful counter-insurgency programme has to diminish that base.

It can be done. The Philippine Military Acad-



Opposition

emy produces plenty of officers who have studied the successful campaigns against communist insurgencies in Malaysia and Thailand. The former chief-of-staff of the armed forces and now defence minister, General Fidel Ramos, is one. General de Villa is another. But can the lessons of Thailand be applied to the Philippines? It would mean setting different kinds of emergency laws for different parts of the country, depending on their exposure to the NPA. It would mean appointing a director of operations—perhaps General de Villa—with absolute power to move men and equipment anywhere. It would mean

establishing a long-term national plan. It would mean putting the AFP's brightest and best, the graduates of the military academy, into the field instead of into cushy staff jobs.

None of those steps looks likely to happen. The experience of martial law under President Marcos makes both Mrs Aquino and the Congress suspicious of any kind of emergency legislation. Long-term planning and volunteering for hardship are not part of the national character. And why appoint a director of operations with powers that would enable him to mount a successful coup?

The best that is likely to happen is a separation of the police from the AFP, as decreed by the new constitution, and a willingness by more officers to move their troops out of the comfort of fixed camps and nearer to the uncomfortable surroundings of the NPA. The first measure would relieve the military of duties for which it is not fitted; the second might well improve morale by putting the NPA on the run. In Mindanao, for example, the colonel of one brigade has taken his men—and their wives, if they want—to a lonely hilltop overlooking spectacular wooded valleys that were once dominated by the NPA. It is no coincidence that the area is now almost free of NPA.

One foreign military expert says the way for the NPA to recover and win is clear. First, it should secure an external supply of weapons, which would mean getting formal help from a communist country (of which, so far, there is little sign). Then, and more vitally, it should assassinate the president. That would not only remove a symbol of goodness, it would also prompt a move to Marcos-style repression and so the collapse of the country. Heaven forbid. So how can the president win? The answer is impossibly easy: eliminate the attraction of communism by eliminating feudalism and poverty.



Questions of land

LASEL VILLARIAS has the kind of routine that in rich countries brings emergency calls from social workers. She is a small, pretty girl of 14 and lives with five younger brothers and sisters in a bamboo house on a sugar plantation in the island of Negros. Her day begins at five o'clock in the morning. "I am the one to cook—rice and green leaves. Then I clean the house and tend the baby. My mother comes home at five, and then I cook in the evening. Sometimes I play games with the children, which makes me happy." At an age when western girls are experimenting with make-up, Lasel has just one pair of earrings; they cost three pesos in the market at Murcia.

There are millions of Lasels in the Philippines. Hundreds of thousands of them escape their surroundings by becoming go-go dancers in Manila and the cities adjacent to the American bases, Olongapo and Angeles. Or, if they are lucky, they go as maids to Hongkong, Singapore, even Canada.

Lasel will probably not escape. Negros is perhaps the poorest island in the Philippines. Some 90% of its people depend directly or indirectly on sugar planting—and the world price of sugar is way

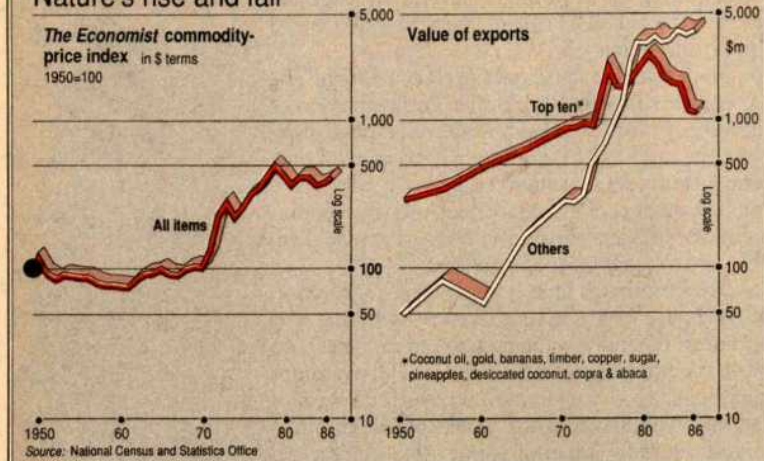
below the local production price of around 14 cents a pound. Some 70% of the sugarlands in the western part of the island are under threat of foreclosure by long-suffering banks. Indeed, the only place where Philippine sugar sells at a profit is America, thanks to a price charitably guaranteed by the American government. The government hospital in Bacolod City, in the province of Negros Occidental, treats 45 children a day for malnutrition. In a fertile land babies starve because they are left with older siblings who have no idea of how to care for them.

The poverty of the island isolates it. The personable young governor, Mr Daniel ("Bitay") Lacson, says: "The people of Negros Occidental did not join the People Power revolution in the streets of Manila. Not because they wouldn't. They couldn't." Manila is an hour's flight away by a ticket no plantation worker can afford, or 18 hours away by inter-island ship (one of its kind, the *Doña Paz*, sank recently with the loss of about 3,000 lives).

Even the sea passage will be beyond Lasel's means. Her father earns just 32 pesos a day in the six months when sugar cane is cut (the rest of the year he has no work, and so no money). Her mother

Land reform is a reformer's nightmare

Nature's rise and fall



earns 800 pesos a month cleaning in nearby Bacolod City. That means the family income in a good month is about \$85—well below the official poverty line. In other words, Lasel will be trapped. If she complies with the statistical norm she will marry very young; have five or six children (two of her pregnancies will be classified as high-risk, and probably one child will die in infancy); and die at least ten years before a farmworker's wife in America or northern Europe. The plight of Negros tends to move foreigners and Filipinos alike to tears.

The question is what to do about it. The NPA's solution is armed revolution. A lot of local churchmen go almost as far, which presumably explains an arson attack on the home in Bacolod of Bishop Antonio Fortich. The government's answer is land reform, not just for Negros (which is something of a special case, given its profitless devotion to a single crop), but for the whole country. Article XIII, section 4, of the new constitution says: "The state shall, by law, undertake an agrarian reform programme founded on the right of farmers and regular farmworkers, who are landless, to own directly or collectively the lands they till or, in the case of other farmworkers, to receive a just share of the fruits thereof."

They are brave words, but their like has been heard before. President Quezon had a "land-for-the landless" programme in the 1930s; President Magsaysay had one in the 1950s; President

Macapagal had a Land Reform Act passed in 1963. In 1972, at the start of martial law, it was the turn of President Marcos, who decreed that rice and corn lands (crony-owned plantations were thus exempted) should be owned by the tenants who worked them. None of these plans has succeeded in destroying either feudalism or the poverty that attaches to it. Mrs Aquino's Comprehensive Agrarian Reform Programme, known by its acronym CARP, covers all arable land, including sugar and coconut plantations. But will it be any more effective than its predecessors?

The answer, sadly, is probably no. The obvious reasons are bureaucratic incompetence, lack of money and the opposition of vested interests. The lesson of the Marcos programme is salutary: after 12 years only 11.5% of the land intended to be covered by the reform had actually been redistributed; only 10% of the beneficiaries had paid off their loans from the Land Bank; and only 13% of the dispossessed landowners had been paid.

CARP is supposed to benefit 2.14m peasants by completing the Marcos programme and then moving on to cover idle land, the sugar, coconut and banana plantations, and public lands. The costing was originally set at around 50 billion pesos over ten years—roughly \$2.5 billion that the government simply does not have. The figures are only vaguely precise: others say that 2.69m tillers qualify for CARP and that it will cost anywhere from 100 billion to 300 billion pesos over ten years. But the idea was, indeed still is, that the money will come from foreign creditors (Jimmy Ongpin claimed half-promises of \$500m), the sale of state assets and the recovery of "ill-gotten wealth" by the Presidential Commission on Good Government (PCGG). So much for hope. Reality is that asset sales—which by the end of 1987 had supposedly raised 8.1 billion pesos over two years—are bogged down in bureaucratic infighting, and that the PCGG has little to show in hard cash for its painstaking efforts to track the Marcos loot around the globe. Senator "Sonny" Alvarez, who devised CARP, says ruefully: "We were over-optimistic."

Yet even arithmetic realism would not have helped much. The world's successful land-reform programmes—it is fashionable to cite Taiwan, Japan and South Korea—have all involved a strong element of compulsion. How else do you persuade those who have land to give it to those who do not,



Perpetual burdens?



especially when the major part of the landowner's compensation is through government bonds that in real terms may lose value? President Aquino had near-dictatorial powers in the period last year before Congress convened; but action by decree is not her style, so she entrusted the legislature with the task of deciding crucial details—such as how much land a landowner may retain. The result surprises nobody. A Senate dominated by lawyers and a House of Representatives dominated by landowners are talking CARP to death, or at best to a meaningless life.

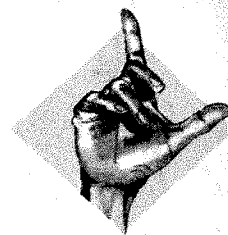
Unreal reform

Perhaps that is the fate CARP deserves. Land reform for the Philippines has become a mantra chanted not just by the Catholic church and the local left but by virtually every foreign pundit. The assumption is that once the peasants own the land they till, the nation's social and economic ills will somehow fade away. But peasants born into feudal dependency will not suddenly learn the skills of how to raise finance, when to plant, and how to sell; teaching those skills implies resources that the Philippines simply does not have. Under the Marcos programme, the clever peasants—a third of the beneficiaries—were those who sold the land they were given, or leased it to new tenants. Meanwhile some 400 rural banks that had supported the Massagana 99 project to increase rice production went bankrupt because of peasants who did not repay their loans.

So what should be done? The landowners, cit-

ing Malaysia as an example, say the government should start with government-owned land, much of it idle, abandoned, foreclosed or sequestered from the Marcos cronies. This, they say, adds up to 4.4m hectares—comfortably above the 3.8m covered by CARP. Governor Lacson, in a plan grudgingly accepted by the sugar planters and grudgingly admired by the sugar-workers' union, says that in Negros the landowners should keep only 60% of their land for sugar; 30% should be diversified into other crops, such as shrimp, mangoes and cashew nuts; and the remaining 10% should go to the peasants so that they can grow food to eat.

The best start is to recognise economic realities before being blinded by social injustice. It would be madness, for example, if CARP were to split up the profitable banana plantations in Mindanao into plots too small to be sprayed from the air against disease. Perhaps the solution lies in "nucleus" estates of the kind being tried in Indonesia: smallholdings would be grouped around a central estate that would handle the services they require and would eventually be owned as a collective by the smallholders themselves. In practice, different areas will require different ideas but the long-term answer is common to all: increase agricultural productivity and use the profits to industrialise and produce goods both for home and abroad. Unlike revolution, that would be a painless way of destroying feudalism. The difficulty is that it implies qualities of organisation and efficiency that in the Philippines are in short supply.



Words rather than action

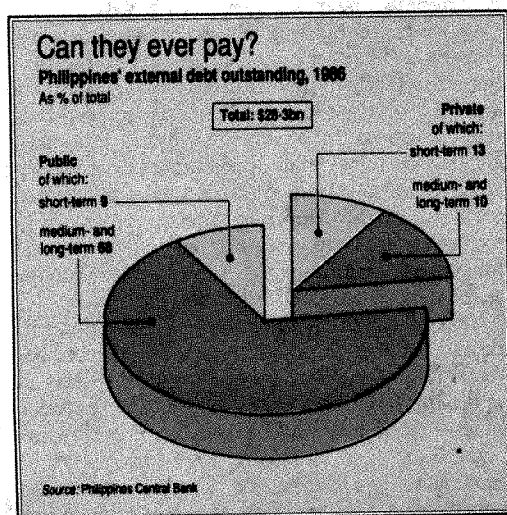
CULTURAL generalisations are risky. Not all Scotsmen are mean; not all Italians are excitable. But surely all Filipinos are eloquent. Turn on the television and there is, invariably, it seems, a political chat-show. Each Monday morning at the Manila Hotel politicians meet the press to debate over breakfast. On other days the politicians can be met at the Intercontinental or the Manila Peninsula. Some senators deliver speeches that would make Demosthenes jealous. Nobody is ever inhibited by

lack of knowledge, experience or information, and eloquence has nothing to do with class: the brown-skinned road sweeper will be as lucid but verbose in Tagalog as the *mestizo* lawyer is in English. In the Philippines, only the telephone system fails to communicate.

The problem is that the torrent of words (memorably described by one foreign diplomat as "fluency without meaning") can obscure the need for action. Filipino columnists and government politicians regularly castigate the rest of the world for offering the Philippines plenty of praise but not enough aid. Yet a look at the aid books shows that more than \$2 billion in official development assistance is unused. Some dollars may be left idle because the central bank does not have counterpart funds available to meet its share of financing projects; most are simply stuck in a pipeline of Philippine bureaucracy. In 1986 donors committed \$3.2 billion, but only \$770m was actually used; in 1987 commitments reached \$3.5 billion, of which \$929m was used. Mr Vicente Jayme, the finance secretary, says fluently that it is "incorrect to say the credits are unused," and explains: "It is not a question of credits or funds lost but a delay in disbursements. They are delayed, but they will be used."

Similar delays affect the programme encouraging foreigners to swap Philippine debt for Philippine equity. The idea has one obvious disadvantage: the inflationary effect of having to provide full peso

Filipinos talk too much for their own good





value for foreign-currency debts bought at a discount. But the advantages are greater: a lightening of the debt burden coupled with new investment to help a workforce growing by 750,000 a year.

So much for theory. In practice, potential investors lose their way in a maze of bureaucracy and contradictory regulations. One company says it has been trying for two years to conclude a debt-equity swap of \$50m to set up a rubber plantation in Mindanao, which is suffering from both communist and Muslim rebellions and is crying out for job-creating investment. A company with a mere \$8m investment needed five months to get the necessary approval. Moreover, it will get worse. Last year applications worth some \$456m were approved; this year the central bank says they will be limited to \$180m. The suspicion must be that Filipino rhetoric has bred an odd kind of chauvinist logic: any foreigner wanting to buy an asset in the Philippines obviously sees a profit and that profit should go to Filipinos, not to foreigners. Because of such thinking a country desperate for foreign investment has an investment code whose incentives are arguably inferior to Vietnam's, let alone those of a robust competitor such as Thailand.

Filipinos may not see it that way. They remember that in 1946, as a precondition of American aid to the newly independent Philippines, the trade agreement gave Americans equal rights to exploit Philippine natural resources. This parity was continued under the Laurel-Langley agreement of 1955 and did not end until 1974, which was when Mr Marcos started encouraging foreign investors at the apparent expense of fledgling Filipino manufacturing companies. The economic nationalism may be foolish, but it is not unfounded and it remains extremely powerful.

The World Bank-approved programme of trade liberalisation by Mrs Aquino's government has lifted tariffs and non-tariff barriers on 1,232 imports; tariffs on another 635 products are due to be lifted in July. But will the technocrats have the courage of their original convictions? The National Economic and Development Authority has already approved a request by the Department of Trade and Industry to slow down the lifting of import restrictions on 673 "strategic items". These mysteriously include packaging materials, glass and unspecified consumer durables. On some 114 imports, such as yellow corn, there may be an "indefinite ban", according to the trade and industry secretary, Mr Jose Concepcion. Pity the poor Filipino consumer, condemned to still more years of inferior domestic goods. No wonder "made in America" and "made in Japan" carry such cachet among Filipinos constantly exhorted by their president to "buy Filipino".

The price of honour

The tendency to let fine-sounding words take precedence over logic might be forgivable if it made everyone happy. But that is not true of the recent "temporary" ban on the right of Filipinas to go overseas to work as maids. Last year some 87,000 Filipinas found work abroad. There are around 34,400 Filipina maids in Hongkong (where they are by far the largest expatriate group) and 17,000 in Singapore. On top of food and board, a maid in



Not happy for them

Hongkong gets a minimum salary of \$295 a month and her counterpart in Singapore \$150. These sums are enough to feed and educate an extended family back home; they compare with the \$40 a month a schoolteacher might make in the Philippines. Not surprisingly, a lot of apartments in Hongkong are being cleaned by Filipina college graduates. Together, the maids remit at least \$1 billion a year back to their cash-strapped country.

Unhappily, many Filipinas who go to Japan as "entertainers" end up as prostitutes. Some who go as maids to the Gulf end up being seduced, or even raped. All this has been well known for years, and is regularly condemned in the Manila media, which just as regularly tells the government to "do" something about it.

Normally, the government says it will do something—and does nothing. But in February, almost it seems by accident, the cabinet decided to impose a temporary (and surely unconstitutional) ban from March 1st on the right of Filipinas to go abroad as maids, except as the servants of Filipino diplomats. The idea was to negotiate appropriate safeguards for the maids in their host countries without having to specify that Arab countries were the target. Even when safeguards had been arranged, the ban would remain on women under 35—an arbitrarily precise age for the end of sexual vulnerability.

Like all too many ideas in the Philippines, this one had not been thought through. To protect their morals Filipinas would apparently have to stay in the Philippines, where almost the only work readily available to them would be as prostitutes. Predictably, the maids in Hongkong were furious. Just as predictably, the Philippine government subsequently announced a lifting of the ban for Hong-

kong lest the maids picket Mrs Aquino's visit there in April. If matters run true to form, the issue—regardless of host country—will fade into oblivion. After all, that is what has happened on other serious matters, such as punishing those who plot to overthrow the state.

Dealing with Uncle Sam

An issue that cannot fade, however, is that of America's bases at Subic Bay and Clark Field (or military facilities under the control of the Armed Forces of the Philippines, as the Americans sometimes remember to stress). Nowhere else is the Philippines' dilemma over its identity so acute. The economic benefits are enormous. Each year American armed forces spend more than \$350m in the Philippines. This includes \$100m in after-hours spending (a lot of it in the tacky bars of Olongapo and Angeles) by 18,000 American personnel and their 19,500 dependants. The bases, directly or indirectly, employ almost 69,000 Filipinos on a payroll second in size only to that of the Philippine government. Imagine the hardship if the bases were to go.

Yet that is precisely what many Filipinos, on the right as well as the left, propose. Mr Blas Ople, a genial politician who was once Mr Marcos's minister of labour, says: "I want the bases to go because most Filipinos instinctively rely on the Americans for everything." Mr Raul Manglapus, a distinguished scholar and politician who is now foreign secretary, points out that the presence of the bases is more likely to attract an attack on the Philippines than their absence would. Why should the Philippines have to host bases which defend Japan and South-East Asia? Even the constitution is hostile. It says starkly: "The Philippines, consistent with the national interest, adopts and pursues a policy of freedom from nuclear weapons in its territory." Although "consistent with the national interest" allows anything to happen, the threat is obvious. And the constitution underlines it by adding that once the agreement on the bases expires in 1991, any new agreement will need a Senate-approved treaty and, "when the Congress so requires", ratification by a national referendum.

Both Filipinos and Americans are hoping that money will resolve the issue. The question is how much. The bases are obviously important: they protect the Indonesian straits of Malacca, Sunda and Lombok, "choke points" through which almost 90% of Japan's oil is shipped from the Gulf. So some Filipinos assume that America will pay almost any price to stay put. Why not, they suggest, the \$20 billion it would supposedly cost to relocate the facilities? Or the \$29 billion that the Philippines owes to foreign banks? Such figures make the Americans



Part of the bargaining process

roll their eyes: payment for the bases is aid, not rent, and other countries, such as Japan, actually pay for American bases on their territory.

But some kind of deal is bound to be offered, and it cannot be long delayed. Although the lease on the bases ends (subject to one year's notice) in 1991, the financial aspects of the agreement depend on an amendment—there have been more than 40 since the agreement was signed in 1947—which expires next year and is due to be renegotiated this year. Under this latest amendment America offered \$500m in "security assistance" for the period 1979-84; a review in 1983 promised a "best effort" to provide \$900m in the period 1984-89. In fact, the Americans, who are not neutral in their support of Mrs Aquino, have managed to commit \$1.14 billion already, with one year still to go. How high the next term's offer will be is genuinely anybody's guess. Too high, and America's Congress will refuse; too low, and the Philippine Congress will do likewise. Setting a price on national honour is a tricky business for everyone.

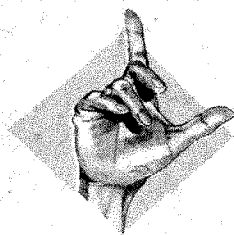


Action rather than words

IT IS easy to say what is wrong in the Philippines. This survey adds more words to the millions that have already pointed out the inefficiencies and inadequacies of the Aquino administration, faults that become steadily more manifest as memories of President Marcos fade. The words are written not just by

foreigners; Filipino columnists are their nation's own harshest critics, finding error at every turn. The same is true of Filipino politicians: they will always be polite to each other, but nonetheless will expose issues with a glee that their sanctimonious counterparts in, say, Singapore would never con-

Let deeds speak for themselves



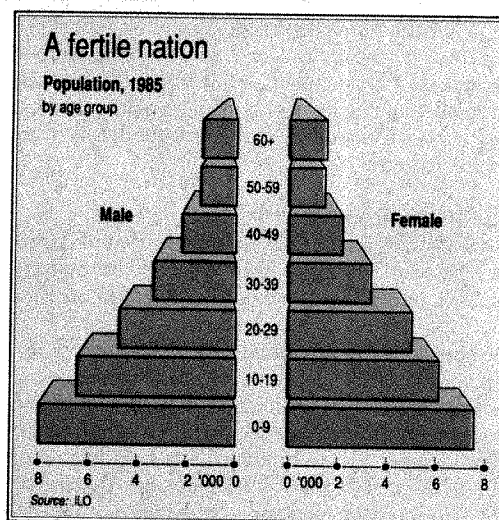
template. They say, for example, that while Mrs Aquino's goodness remains, "Cory magic" has faded; her relatives are using her name to seek political and business power (although, in fact, many of her relatives lost in January's local elections); and Philippine politics is reverting to its self-interested type.

All of this may be true, if only in part, and all the millions of words devoted to it may well frighten much-needed foreign investment to places perceived as more stable, more honest, more profitable. But the words, harmful or not, are crucial to the identity the Philippines is still seeking. What separates the country from the rest of East Asia is its sense of openness, freedom and fun. It may take years to become friends with a Chinese; a Filipino becomes an apparent intimate within minutes. The reason that westerners are so pained by the Philippines' poverty, which is actually not nearly as bad as that of some developing countries, is that Filipinos are so articulate, talented and, for want of a better word, nice. The problem is that as the gap between potential and achievement remains so wide, even the most sympathetic of outsiders become exasperated.

It need not be so. A debt rescheduling last year has brought relief until 1992. Mrs Aquino's determination to bring back democracy has survived all the coup attempts and gained four years of political stability. The Philippines does not require armed revolution or dictatorial rule to pull it out of its feudal misery. It needs merely a few more people actually to do what they say. Mrs Aquino's team came to power with all the right economic ideas: end monopolies; liberalise trade; reform agriculture; promote exports of manufactures. And they worked: in 1986 fertiliser prices dropped by a third and prices of copra at the farmgate almost doubled. Last year an economy primed by election spending boomed enough for San Miguel's beer sales to grow by 30%. Despite the coup attempts and the October crash, brokers claim the Manila and Makati stock exchanges were the world's best performers.



The triumph...



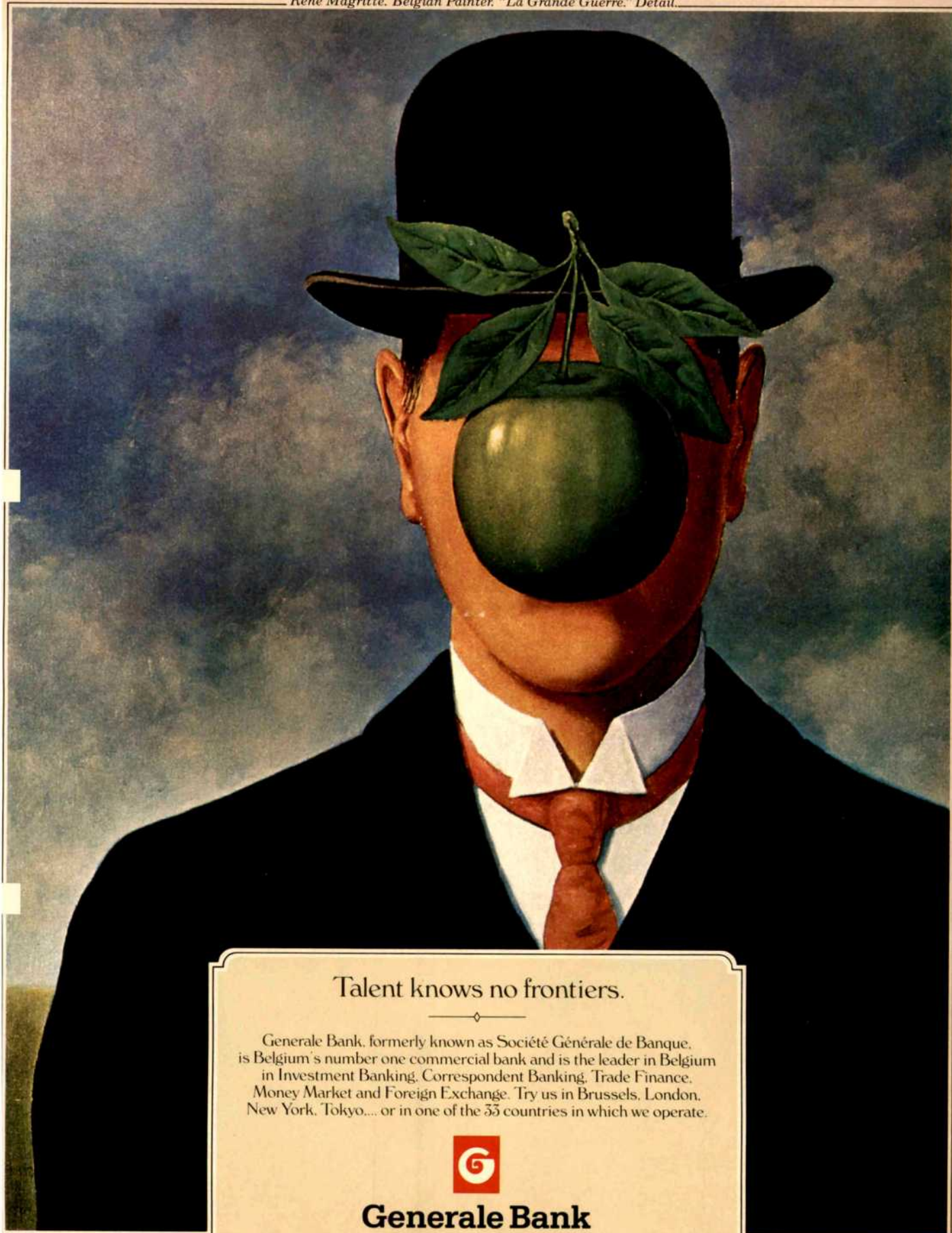
But the ideas worked only up to a point. They were compromised by maladministration, corruption and occasionally cowardice. One reason that sales of state assets such as Philippine Airlines and the Manila Hotel have gone so slowly, or not at all, is that the people placed in charge of them have no intention of working themselves out of well-paid jobs. The danger now is that the ideas will be not just compromised but forgotten, especially as the politicians, who project personality without policy, position themselves for the 1992 elections (in which Mrs Aquino says she will not run). And if the ideas are forgotten, if the Philippines fails to break from its feudal obsessions, then ultimately disaster is inevitable—if only because two or three Filipino babies are born every minute.

A year ago Mrs Aquino inaugurated a shrine on EDSA saying: "In a shining moment in the world's history, God's favour came to rest on Filipinos... He has brought down rulers from their thrones but has lifted up the humble." Let the rest of mankind pray that humble Filipinos are lifted at least a little bit higher.



... and the tragedy

René Magritte. Belgian Painter. "La Grande Guerre." Detail.



Talent knows no frontiers.

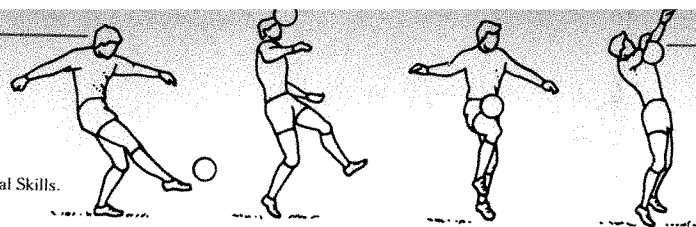
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Fig. 1: Individual Skills.



ATTITUDE AND TECHNICAL EXCELLENCE - EQUALLY IMPORTANT IN ACHIEVING RESULTS -

KICK OFF: That it gave its name to the many sports that declare themselves 'football' is indicative of two things.

Firstly, that football (or soccer as we must now specify) is an original sport (referred to in Chinese history as early as 206 BC). And secondly, that all forms of football consider their own pre-eminent.

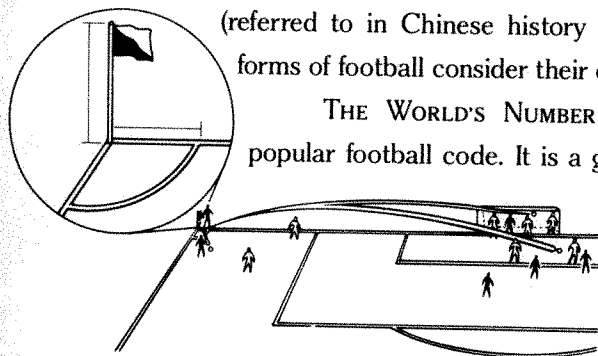


Fig. 2: Options for Success.

THE WORLD'S NUMBER ONE: Today, soccer is the world's most popular football code. It is a game of fluid movements and varied patterns.

Although individual attacking raids and the flair of the gifted performer are spectacular, it is fair to say that football is essentially a team game.

THE TEAM: To score goals, the ultimate aim of the game of soccer, accurate passing of the ball amongst team members is paramount. Because of this interdependence, a spirit of camaraderie is essential to the competitive team.

Attitude is as important as technical excellence in achieving results. By practising a great deal together and learning team skills, the team can develop that most rare commodity: confidence in each other.

For, as in all team endeavour, confidence and competence are two sides of one coin.

The 'team' philosophy has been integral in the ascension of Westpac as Australia's world bank.

To talk trade and project finance, foreign exchange and interest rate risk management, capital and money markets, contact Australia's largest and most experienced banking and finance group.

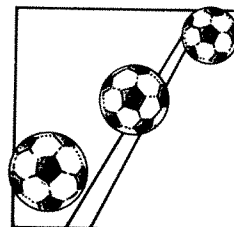


Fig. 3: Play by the Rules.

Westpac
Australia's world bank.

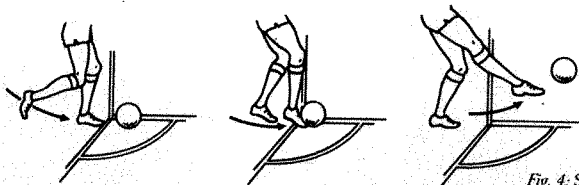


Fig. 4: Specialist to the fore.

Bahrain, Beijing, Chicago, Columbus, Frankfurt, Honiara, Hong Kong, Houston, Jakarta, Jersey, Kuala Lumpur, London, Los Angeles, New York, Port Moresby, San Francisco, Seoul, Singapore, Suva, Sydney, Taipei, Tarawa Bairiki, Tokyo, Vila, Wellington.

BRITAIN

One more defeat on the long retreat

ONCE upon a time a big industrial dispute in Britain meant a national crisis. Today it usually means that some trade union is on a hiding to nothing. Britain's unions are enmeshed in legal restraints, losing members, divided. A strike by the National Union of Seamen, which has almost halted cross-Channel ferry traffic over two holiday periods, has been virtually ignored by the government, and has demonstrated once again the weakness of organised labour.

The seamen have now crossed the line between frustration and desperation. For 14 weeks their union has been on strike against proposals by P&O to change working conditions and to cut manning on its Channel ferries. P&O holds all the trumps; it has sacked 873 workers, and persuaded others to break the strike.

So Mr Sam McCluskie, the union's general secretary, ordered his members to strike

illegally against Sealink (another ferry firm) against which they have no grievance. Since the High Court had told him not to, the union was promptly fined £150,000 and had its assets seized. Although the strike continues, Mr McCluskie has already given up hope of spreading it (against the law) from ferries to cruise ships.

The dispute has shown the devastating effect of Tory industrial-relations law. Until Mrs Margaret Thatcher's government came to power, unions had got into the habit of winning strikes by "secondary action"—mobilising workers in other firms or industries against their employers. That was made possible by trade unions' immunity from the law, granted in 1906 and not seriously curtailed until 1980. Now that secondary picketing is illegal, a union such as the NUS cannot take action against another employer for which its members work but with which it has no dispute. Nor can one union take ac-

tion to support another, without putting its assets at risk. The larger the union, the larger its assets, and the more it stands to lose by breaking the law.

Without secondary picketing, the main way in which the Trades Union Congress (TUC) can offer help to an embattled member has gone—and with it one of the main forces for cohesion among Britain's different unions. Since 1985 miners, printworkers and civil servants have been defeated because their leaders all found they could not win strikes by persuading other unions to put pressure on their employers' suppliers, customers and competitors.

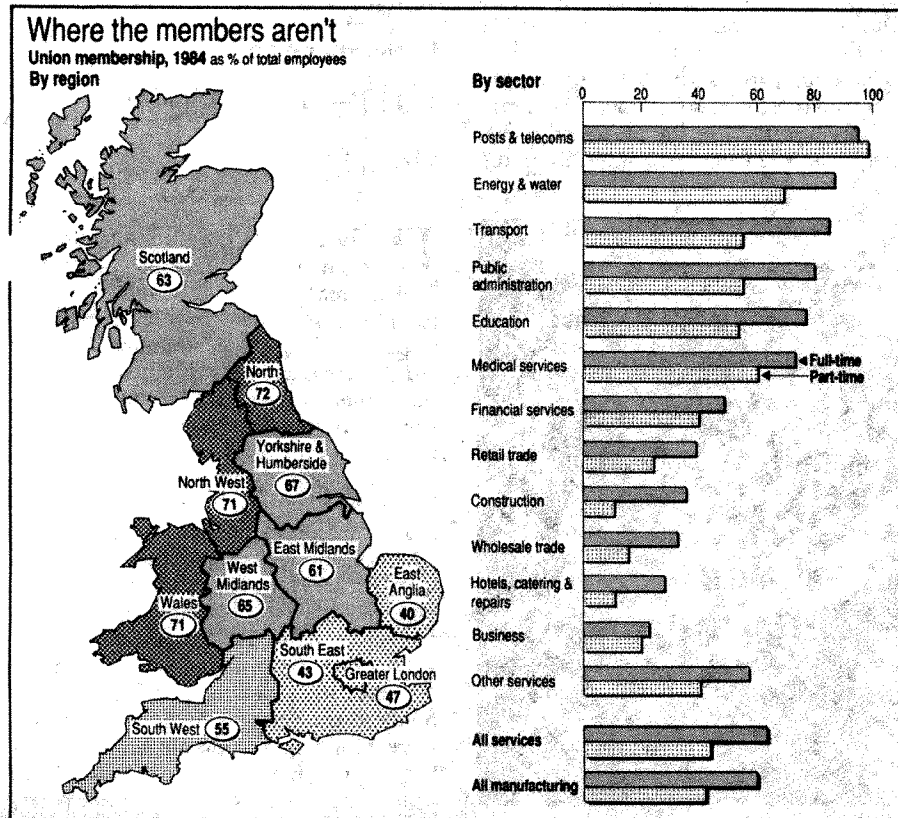
Even without the law to divide them, the interests of the unions would have increasingly diverged. A handful of unions, their members' skills overtaken by technological or economic change, have tried to defend jobs in industries where fewer workers are needed, by staging noisy strikes. Next into the breach may be the television technicians, already driven out of one commercial company, TV-am, and struggling to keep their members' jobs in others. The preoccupations of such unions are quite different from those of most other TUC members. The other unions are worrying about ways to recruit part-timers, and to make themselves more attractive to women. They know that strikes are the worst possible publicity for unions, and the greatest deterrent to potential new members.

Cultural decline

The rout of the unions has been accomplished not merely by changes in law, but by changes in the pattern of employment. At the end of 1986 (the most recent figures) union membership was 10.5m, which was already 20.7% below its 1979 peak.

The fall is not yet as dramatic as the long decline which followed the first world war. That nearly halved union membership from a peak of 8.3m in 1920 to 4.4m in 1933. Today's fall will not go as far as that. Among employees, indeed, the density of union membership may now no longer be declining. Figures from the Social Attitudes Survey, published in the current *Employment Gazette*, suggest union density was virtually unchanged between 1984 and 1986. But this still means that relatively fewer British workers are in unions, if only because of the growth in self-employment in Britain.

That is little help to the unions. And indeed, union membership is highest in the kinds of employment and parts of the country with slowest growth, and lowest in the new boom occupations and areas. That is emphasised by two studies published this



A Rocky case

IN THE space of six days the foreign secretary, Sir Geoffrey Howe, has tried to stop the screening of two television programmes, one by a commercial channel and one by the BBC. He approached, first, the Independent Broadcasting Authority (IBA) and later the chairman of the BBC to protest about the showings of two investigative programmes on the killings of three Irish Republican Army terrorists in Gibraltar by the British army's SAS. Both programmes contain interviews with witnesses who claimed that the terrorists were shot while in the process of surrendering. The government claimed that, if the programmes were shown in Britain, they would prejudice the forthcoming inquest in Gibraltar.

Under the terms of the Broadcasting Act, the job of deciding what should be

shown on television is vested in the IBA (for the commercial channels) and the board of governors for the BBC. The act's original intention was to prevent the government of the day from interfering in those judgments. The present government therefore has no legal case for intervening. The Foreign Office, the IBA and Thames all consulted lawyers, who advised them that transmission was perfectly legal and did not constitute contempt of court.

The prime minister was said to be "beyond fury" that the IBA ignored Sir Geoffrey's request. Some newspapers immediately spread stories that the IBA was to be abolished, printed smears about the main witness in the Thames TV programme, and claimed (to subsequent denials) that Thames's shareholders were angry about

the programme being transmitted.

The government's position is weak on two counts. First, it has illogically singled out television: newspapers have already carried long articles on the shootings, and these would be even more likely than television to find their way to Gibraltar to prejudice the chances of a fair inquest. Second, the government has never given a clear commitment to co-operate fully with the inquest in Gibraltar. Had it done so, its reluctance to see the programmes broadcast before an inquest was held would have carried a lot more conviction.

As it is, ministers might use the programmes as one more excuse for refusing to allow the coroner in Gibraltar to hear the SAS side of the story. That would be a bad mistake. Without full testimony from the SAS men, the suspicion will remain that they had orders to shoot the IRA terrorists on sight—armed or unarmed, surrendering or not.

week.

One*, by two academic economists, looks at the proportion of workers in establishments where unions are recognised for collective bargaining. For Britain as a whole it finds a decline from 83.7% in 1980 to 70.3% in 1984 in the numbers of manual workers in unionised establishments, and a parallel decline from 61.3% to 48.7% for non-manual workers. For both white-collar and blue-collar workers, the survey found that unionism is strongest in the slow-growing regions of north and west Britain, and weakest in south and east England.

A second and more elaborate study† by two government officials tracks union density, measured by union members as a proportion of employees, in the main industries. They find (see chart on previous page) that in most industries union membership is higher among full-timers than part-timers; but both full-timers and part-timers are more likely to belong to a union in the public sector, in a big establishment, and when trade unions are recognised by an employer. The study also found big regional differences (see map). Workers in the north and west are more likely to be union members than those in the south and east. In the four southern regions, part-timers are less likely to be union members, compared with full-timers in the same industry, than in the rest of the country. Indeed, in Greater London full-timers are more than twice as likely to be union members than are part-timers; in

Yorkshire and Humberside only 1.2 times as likely.

Union strongholds are in the Labour-voting, slow-growing parts of Britain, rather than in the prosperous parts of the Tory-voting south and east. Both studies conclude that these regional differences cannot simply be explained by differences in industrial structure or the size of a workplace. Some cultural force is also at work. Other surveys are discovering that union members tend to live in the same parts of town as other union members; they are more likely to have had parents who were union members than those who do not join. The north, with its history of highly unionised industries, has a different tradition from the south.



Voting for oblivion

The government's legislation, which looks so likely to break the seamen's strike, is a sign of a changing culture. Some trade unions will continue to ignore the change, throwing themselves into oblivion. But these unions and their fate will become increasingly irrelevant to the main argument within the TUC, which will be about where to find new members, rather than how to save superfluous craft jobs.

Public spending

When more is worse

JUST for a change, the government has accepted the recommendations of a House of Commons select committee. The apparently banal issue: how to publish information about public spending. On May 3rd the Treasury said it planned to expand the autumn statement published each November, but to drop January's big public-spending white paper in favour of reports, separately published by each department. Mr Terence Higgins, chairman of the Commons Treasury committee, welcomed this endorsement of its proposals. He should remember his Homer: beware the Treasury, especially when it is bringing gifts.

Advocates of the change argue that the public-spending white paper now contains no news, since the main decisions are announced the previous autumn. They want more information on output and objectives, but suggest that adding to an already fat white paper would put off even more potential readers (including MPs). And they point

*The north-south divide in Britain: the case of trade union recognition. By Phillip Beaumont and Richard Harris. Department of Economics, Queen's University, Belfast.

† Union density in the regions. By Neil Millward and Mark Stevens. *Employment Gazette*, May 1988.

to the dullness of parliamentary debates on public spending, and the failure of many select committees to use the white paper to interrogate their departments, as further reasons for change.

The past few years have seen a steady improvement in the white paper, which now contains a summary of objectives, spending and performance measures right across Whitehall. More is still needed, especially from those departments like agriculture and the environment that have been weakest on measuring their output. Length need not be a bar: the latest budget presented to Congress by the American president runs to five volumes and 2,467 pages, compared with the British Treasury's two volumes and 520 pages. As for parliamentary neglect, that is surely a criticism of MPs, not of the published documents.

Were the white paper split into longer departmental reports, crucial comparisons between departments could become harder, or easier—especially if (as seems possible) the reports were published on different days. And central editorial control might be weakened. The present white paper is emphatically a Treasury document even though other departments contribute most of the chapters, whereas departmental reports would presumably be controlled by

spending ministers. The Treasury would try to lay down central rules, but they would be easier to evade.

Why then is the Treasury so keen to agree? One explanation may be that it was annoyed that this year's white paper and debate gave critics two separate chances to talk about health-service spending ahead of the budget. This made it even harder to sustain the Treasury's absurd doctrine that spending can be decided only in the autumn and tax only in the spring. If departmental reports were published on the day of the budget itself, that might undermine the doctrine still further. But it could also provide a convenient way of burying evidence of poor departmental performance beneath a welter of tax-change publicity.

Mr Higgins's committee (and its sister-committee on public accounts) has one more chance to change its ideas. The best compromise would be to expand the autumn statement but still keep the more detailed spending white paper in January. Departments could then be invited to publish annual reports in the summer that would include the previous year's accounts. Whitehall departments would then look even more like the private companies they are so often begged to copy—and which some of them may yet be turned into.

say nothing of the Japanese. Most of Japan's six giant construction companies have hitherto generated only about 5% of their turnover abroad. Kumagai-Gumi, one of the six, does things differently. Nearly half of its turnover is now outside Japan.

Kumagai-Gumi is the contractor at several of London's big new projects, as well as at one in Glasgow. Typically, it spots a site with development potential, arranges financing with Japanese banks, and then takes the head-contract on the construction site. Sub-contracts are handed out to friendly local contractors.

The Reading team, which has also produced a new report on the Japanese construction industry, thinks that where Kumagai-Gumi has led, other Japanese firms will eventually follow. These firms are the world's leaders in high-technology building, including the use of robots both in the materials industry and on site.

British firms have improved. Productivity rose during the years of high unemployment in the early 1980s. In 1979 British buildings went up 41% more slowly than American ones; in 1986 only 21% more slowly. Big British builders are less likely to sit and wait for the government to give them contracts. They now take a lead (witness the Costain Group's recent proposals for new motorways and railways) in identifying projects before Whitehall has.

All this the Reading study acknowledges. But its main message is that no British firm is yet big enough to compete globally. Like all construction industries, including Japan's, Britain's is fragmented: of more than 170,000 building firms, over 90% employ fewer than eight people. The big firms—100 of them account for almost 20% of the industry's output—are giants by British standards, not by international ones.

By the end of the century, thinks Mr Bennett, 20-30 European firms will be five to six times bigger than the biggest British firm now. That would make them about the same size as the Japanese giants. If mergers and

Construction

On shaky foundations

BUILDERS in Britain are having a ball. Schemes like Canary Wharf, in the Docklands, and the planned development of a 125-acre site behind King's Cross station have made London the office-building capital of the world. The coming privatisation of the electricity-supply industry has encouraged some big firms to consider building and operating power stations; privatisation of the water boards may release lots of land for development. Proposals for privately financed infrastructure projects are thudding through the Treasury's door. All this, and the Channel Tunnel too.

Tarmac, one of Britain's largest construction and building-materials companies, has just announced pre-tax profits up 56%, to £265.4m, in 1987. Turnover, at £2.2 billion, was up 27%. A few days earlier, the National Council of Building Materials Producers raised its forecast growth of construction-industry output in 1988 from 5% (last November's estimate) to 8%.

The euphoria, unprecedented for 20 years, should be slightly dampened by a report from a team led by Mr John Bennett, of the Centre for Strategic Studies in Construction at Reading University. If Britain's builders (who jointly commissioned the report with the environment department) do

not plan for the future, says Mr Bennett, they will become mere stylists and subcontractors to firms from other industries, or to building firms from overseas.

Today's surge in demand has led to severe skill-shortages in south-east England. Capacity constraints in building materials are becoming more and more evident. They are being relieved by extensive imports. Around 20% of total building materials by value is imported each year, but Mr Bennett estimates that, in high-technology materials (like air-conditioners and sophisticated curtain-walls), imports are now more than 30% of demand.

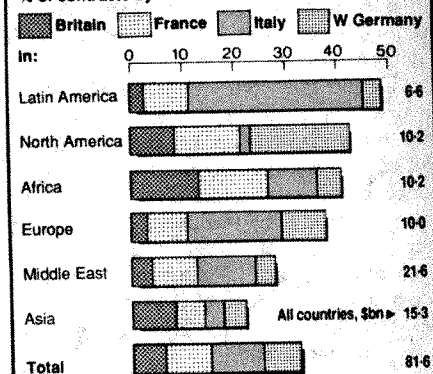
Contractors are facing new competition from firms outside the building industry. British Aerospace, for example, has just bought a leading Dutch construction company. It is likely to offer those who buy its aircraft the chance to get custom-built hangars and airfields in one "turnkey" contract. The Reading report muses that a company like IBM may soon offer building as a service to those who buy its large computer systems.

Where they have already had to compete with foreign construction firms in third markets, British contractors have not been strikingly successful (see chart), compared with the Germans, French and Italians—to

Building abroad

Construction export market, 1985*

% of contracts by value awarded to firms from:



Source: Engineering News Record *Top 250 international contractors

BRITAIN

joint ventures do not happen soon, the Reading report suggests that it will be builders from outside the country, not the British, who mark the next building boom with profits like those that Tarmac has just reported.

Private health

Competitive cure

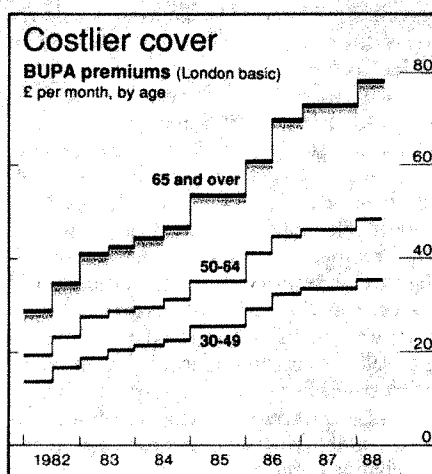
IF PEOPLE are worried about the National Health Service, they might be expected to turn to private health care. They have done so: some 10% of the population now has private health insurance, compared with 5% in 1979. But the increase may be slowing, for a good old-fashioned reason: price. Premiums for people of all ages have doubled in real terms in the past eight years. The rise has been fastest for the over 65s (see chart), who often find that they have to pay more just at the point that their employers have stopped helping with their premiums.

The main cause of higher premiums has been escalating private health-care costs, something more familiar to Americans than to Britons. The British insurers have been slow to bring in the sort of cost-containment measures or new insurance packages that could make their product cheaper and more attractive. But on May 4th the biggest insurer, BUPA, came up with its own response, called "Budget BUPA".

Budget-BUPA is a special limited-cover insurance package with premiums as low as a third of the normal rate. Another unusual feature is that old people can join right up to the age of 75, though they cannot expect treatment for a condition they have already. The scheme has some formidable catches: patients who need non-urgent care may wait for up to five weeks, treatments like organ transplants and kidney dialysis are excluded, and there is a ceiling on payments of £15,000 a year, an optional "excess" or client co-payment of up to £1,000 and a restricted choice of hospital. Still, 85 private hospitals (including those owned by BUPA itself) have accepted tightly negotiated fixed-price terms for surgical procedures. The insurers hope most NHS hospitals with "paybeds" will do so too.

Despite the catches, the scheme will pull in new clients—for it is cannily aimed at a gap in the market that is the NHS's weakest point: long waiting lists for routine surgery for such things as hernias and artificial hips. BUPA is introducing it, not out of a sense of public duty, but because it has been squeezed by rivals: its share of the market has fallen from 70% to 60% in just six years. Most of the business has gone to aggressive commercial insurers.

Competition has been fiercest for the fast-growing company market, which now



Source: BUPA

accounts for over half of all private health insurance compared with less than 40% in 1977. The BUPA scheme is aimed more at individuals than at companies: unlike normal health-insurance schemes there is no discount for group membership. So companies will go on shopping around for better private health deals.

The best such deals are usually tailored packages arranged by third-party intermediaries. Administrative costs can be much lower, and benefits can be adjusted to meet the wishes of individual companies (or their employees).

Bigger companies are going further: operating a form of self-insurance with a stop-loss provision through captive insurers. One of Britain's fastest-growing intermediaries, a Bristol-based firm called Medisure, does this for Bank of America. ICI and the Maxwell Communications Corporation have similar arrangements. Companies cannot simply take the risk themselves, because payment of an employee's hospital bills would count as a taxable benefit; but several are looking carefully at trusts that might get round the Inland Revenue's rules.

Broadcast news

An independent account

FOR more than half a century, the reassuring tones of BBC newscasters have informed British television viewers about world events. For the past 33 years, they have been joined by the equally authoritative—but slightly less staid—Independent Television News, which serves ITV and Channel 4. Now that cosy duopoly is being challenged by small, independent production companies which reckon they can deliver the news to people's sitting rooms more cheaply and more efficiently.

Last year London Weekend Television

took what seemed then like the radical step of allowing an independent company, Screen News, to produce about half an hour of local news each weekend. This year two much bigger contracts—to televise the House of Commons, and to provide a 56-hour-a-week news service for British Satellite Broadcasting (BSB)—are up for grabs. Both, it had been assumed, would go to ITN, perhaps in conjunction with the BBC. Now it looks as if the independents may snatch them.

The BBC and ITN have jointly been filming the House of Lords for three years. They seemed the natural choice for televising the Commons. But some of the ITV companies are starting to wonder whether they might not be better off with an independent company; and some of the members of Parliament on the select committee examining the issue may end up sharing their view.

Tenders have to be in by May 19th, and already some independent companies have decided to bid. TV-am, the company which has the breakfast-time ITV franchise, has written to the select committee, backing the independents rather than ITN. No ITV company has publicly followed suit, but several are thought to be of like mind. Given that many of them are shareholders of ITN, why the switch?

The televising of Parliament will provide wonderful raw material for ITV companies' regional news programmes. They will be able to show local MPs raising matters of local concern, which would not be aired on ITN's national news. But will ITN have the resources or the will to provide this regional material? The more sceptical of the ITV companies think not. They would rather deal with an eager independent company which has no news of its own to organise and can buy the most up-to-date equipment—manned by non-union, or at least non-stroppy, technicians.

The ITV companies have long been irritated by the expense of ITN. It charges £50r a year to provide less than 24 hours of news a week to ITV and Channel 4. Yet BSB managed to beat it down from around £20m to just over £10m for the provision of 56 hours of news a week, when the two companies had a tentative agreement earlier this year. Even so, ITN has now lost that contract; BSB feared that, when ITN had interesting footage of news events, it would use it on its own bulletins before offering it to BSB.

Before the proliferation of TV channels around the world, the idea of an independent company being able to provide BSB with news would have seemed absurd. Only network-news operations like ITN had adequate crews. If their film arrived back in Britain before the BBC's, they would have a scoop. Now film of any big event is widely and almost instantaneously available, either through specialised news channels, such as CNN in America, or through TV news agen-

The pint-sized monopoly

Britain's milk market has been rigged since 1933 in order to raise farmers' incomes. That may change, though not much, when imports of fresh milk from Europe are allowed next year

IMAGINE a business which has no contact with its customers, which never needs to know what its product is being used for, which does not carry its goods to market, but which always has a protected outlet for them at a guaranteed price. That is the kind of business which the average British dairy farmer runs.

Britain's 47,000 dairy farmers produce between them 26.4 billion pints of milk a year—£2 billion-worth. Yet farmers sell less than 2% of that milk directly to consumers, shops, creameries and dairies. The rest is picked up from the farm in its raw untreated state by hauliers hired by a

their product is for drinking.

This monopoly power hopelessly distorts the market. By paying farmers the same whether their milk is easy or difficult to transport, the MMB removes the incentive to keep dairy cattle close to milk buyers. In England and Wales, much dairy farming is in the west, often 100 or more miles from the big conurbations of the east. The Ministry of Agriculture does not mind; it sees the MMB as a sort of surrogate regional policy.

The milk monopoly has another distorting effect: it makes milk more expensive. Comparisons are hard, since milk is

ter and yoghurt from the European continent keep down the prices of these things to the British consumer.

We like it this way

As yet, there is little pressure for change. The convenience of doorstep delivery means that few consumers worry about an extra penny or two on the price of their pint. The monopoly-exploited Britons are among the biggest consumers of fresh milk in Europe.

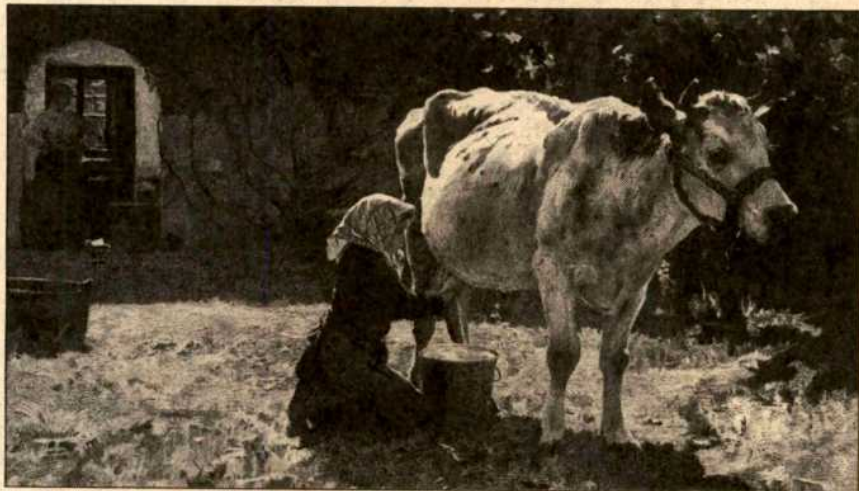
The dairy industry likes being able to pass on high prices to consumers. It enjoys the simplicity of having just one supplier. Poor farmers in remote parts of the country have a vested interest in maintaining the system. Even farmers who might sell their milk entirely into the liquid market (and would therefore get more for it) are reluctant to lobby for a change. Only a few big ones, such as Lord Rayleigh's Dairies, are in the haulage and processing business too. For the rest, ignorance of marketing makes them fear deregulation.

Yet some change should come as early as next year. After a long legal battle the government has been forced to drop rules that prevent the import of fresh milk. At the beginning of 1989 British retailers will be able to buy fresh milk from Holland, France, Ireland or anywhere else in the EEC that wants to export it. Cheap imported milk may not turn up on Britain's doorsteps, but it will appear on the shelves of its supermarkets.

That might force the MMB and the DTF to think again about their milk-pricing negotiations, and in particular about the premium that liquid milk commands over milk for other uses. The government might have to think out what kind of milk market it wants. One that was entirely unregulated would bring variations in price according to geography and according to the seasons (40% more milk is produced in May than in September). One that gave farmers enough market power to stand up to the dairy trade might look much like the co-operatives common elsewhere in Europe.

Some people want to abolish the MMB. Mr Barry Wilson, a farming writer, argues that the MMB has been bad for farmers: their average returns have risen only 1.7% a year since 1984. He wants to shut down the MMB, and distribute its assets to farmers.

Another possible policy would be to leave the milk boards in place, but to remove their statutory monopoly powers. Farmers would then be free to sell their milk direct to dairies or supermarkets if they wanted. If enough did, the average price paid to the others would have to fall—and so, in turn, would the milk boards.



Competitive cow

milk marketing board. The farmer gets from the milk board a price (on average about 9.3p per pint in the year ended in March 1988) which varies a little during the year, but does not depend on whether the milk is used for drinking or butter production, nor on whether it is delivered to a milk-powder factory ten miles away or to a bottling plant 200 miles away.

The milk boards—one for England and Wales, three for Scotland, one for Northern Ireland—were first set up by the MacDonald government in the 1933 slump to strengthen the hand of small dairy farmers against the big dairy companies. The biggest milk board, the Milk Marketing Board of England and Wales (MMB), covers four-fifths of all British milk production. It describes itself as a producers' co-operative subject to referendum. It is also a closed shop: farmers must obtain licences from it if they want to sell their milk independently, and then pay a levy if

delivered to the doorstep in Britain but not in most of continental Europe; but in 1980 the Consumers Association reckoned that the retail price of a British pint was the highest in Europe.

The MMB cannot take full advantage of its monopoly power, because the market is rigged on the demand side too, with the government's blessing. Prices are negotiated with a single buyers' body, the Dairy Trade Federation. Some farmers complain that the dairies' buying power has restricted their share of what housewives pay for milk. For between them the MMB and the DTF fix milk prices to customers which are fairly constant across the country, but which discriminate between different uses of milk. Last year the MMB sold milk for drinking at almost 11.4p a pint, milk for butter at only 8.1p.

This discrimination is possible because, at present, imports of fresh liquid milk are banned. Imports of cheese, but-

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cies, such as WTN or Visnews. A domestic news operation can buy almost all the pictures it wants; all it needs is an interpretative twist from a journalist. This is precisely what the independents think they can offer.

ITN and the BBC still have the edge on domestic coverage. Indeed the BBC is trying to widen that gap by recruiting about 30 new specialist journalists in the fields of British politics, social affairs and business. ITN, shaken by the loss of the BSB contract, plans to turn itself into a leaner organisation. Last month it announced plans to shed 142 jobs and make working practices more flexible. The two giants now recognise that they need to compete not only with each other, but with the newcomers too.

Airports

Bigger Biggin

ONE of Britain's most famous wartime airfields, Biggin Hill at Bromley in Kent, has now become London's main airport for executive travel. It has been an airfield since 1917. During the second world war it was a RAF fighter station, base for Hur-

ricanes and Spitfires in the Battle of Britain. In 1959 the Ministry of Defence handed it over for civilian use. In recent years it has concentrated on the growing demand for executive air travel in private jets and now handles more than 100,000 "general aviation" landings and take-offs a year. It has captured much of this business from London's three main passenger airports—Heathrow, Gatwick and Stansted—which between them have only 42,000 general-aviation movements. These airports now belong to the newly privatised BAA (formerly British Airports Authority).

With increasing congestion of London's airspace and stories of a series of near-misses, the use of Heathrow and Gatwick has become increasingly expensive, inconvenient and supposedly hazardous for tycoons and showbiz stars who want to flit in and out of London.

Biggin Hill is now linked to the full London airways radar and surveillance system and has far lower charges for executive aircraft than its big brothers. But the three main requirements of top business travellers are speed, security and privacy. Biggin Hill's passengers can be through immigration and customs, which are only a few steps from the aircraft parking rank, in minutes after ar-

rival and into a helicopter or on to the anonymity of London's M25 orbital motorway.

London's top security airport is still RAF Northolt. It is regularly used by ministers and senior civil servants (particularly those commuting to Northern Ireland) as well as by members of the royal family. However Biggin Hill has just received an accolade: Prince Charles, at the controls of one of the new BA 146 jets of the Queen's Flight, flew in from Cornwall and was away within five minutes of landing.

Biggin Hill belongs to the London borough of Bromley but is operated by Biggin Hill Airport Ltd as a joint venture with a former RAF fighter pilot turned entrepreneur, Mr Jock Maitland. Bromley gets 65%, and Mr Maitland 35%, of any profit. Last year the enterprise made a loss (of £19,000), but it seems set to move into profit in 1988.

The management agreement with Mr Maitland expires in 1991. In June Bromley council will consider whether to extend it. They intend to keep the airfield, but at least two groups want to run it: Airports UK (a subsidiary of BAA), and Field Aviation (a subsidiary of Hunting Associated Industries). Alternatively, the council may allow a management buyout by Mr Maitland's staff.

The best years of their lives

A FORGOTTEN army has just held its final reunion. Fifty years after the first of its members took to the fields, some 600 ex-members of the Women's Land Army gathered at the Grand Hotel in Birmingham. They were addressed by their patron, the Queen Mother, and spent a day singing old songs, swapping stories and reminiscing about their war, as old soldiers are wont to do.

Their war was important. In 1939 Britain produced only about 40% of its own food, from some 12m acres of land. After France fell, the Germans were expected to try to cut Britain's ocean supply lines with their submarines and starve it. They might have succeeded had it not been for the all-out effort to expand food production. By promising Britain's farmers and landowners a cash grant per acre if they co-operated and confiscation if they did not, the government forced them to bring another 12m acres of farmland and 16m acres of marsh and woodland under the plough in less than four years. By 1943 the country was producing 70% of its food requirements.

A lot of the work was done by the "land girls", whose numbers rose to 90,000 by 1944. They came from all walks of life and from all parts of the country, into what was by no means a Girl Guides'

junket. The official work week was 50 hours in the summer and 48 in the winter, but in practice usually more. The only days off were bank holidays and, usually but not always, Sundays. Wages started at 18 shillings a week and rose to 48 shillings by 1944.

The minimum age was 17, but some of the "girls" were middle-aged. A few re-

ceived a bit of training; most were simply given a uniform and sent directly to work. City girls were sometimes given a "test", such as lifting a heavy sack of potatoes, which was supposed to determine whether they were up to heavy farm labour. They lived either in barracks, from where they were assigned to local farm work, or sent out in ones and twos to live with farmers' families. The girls in the barracks say they had more fun, and were less likely to be exploited.

The land army proved an effective mixer. Former debutantes and former domestic servants lived and worked together, often far from home; after the war many of the girls originally from slums settled where they had worked. Others met their eventual husbands, especially as by 1943 so many American army camps and airfields were enlivening the British countryside. The programme was not wound up until 1950. Many of the veterans today look back on their land-army service as the best years of their lives, but complain that the country quickly forgot their wartime efforts. Their organisation has seldom been included in commemorative ceremonies.

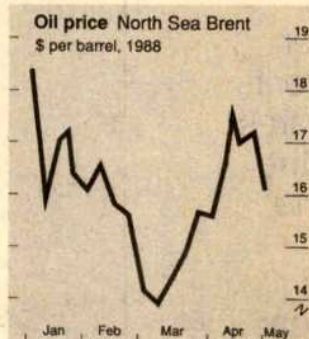
The Queen Mother, then Queen, often visited the girls on the land in wartime. Her presence at their final gathering went part of the way towards granting them, at the end of their era, the recognition that they have wanted for so long.



Harvesting victory

BUSINESS THIS WEEK

Commodities



Oil prices fell by \$1.25 a barrel when OPEC, meeting in Vienna, failed to reach agreement with six non-OPEC producers to cut oil exports by 5%. Separately, the **Kuwait Investment Office's** 22% stake in BP was referred to Britain's Monopolies and Mergers Commission for investigation.

Delegates to the **International Coffee Organisation** ended a week-long meeting in which America threatened to pull out of the cartel unless it reformed itself.

The 17 **Antarctic Treaty** governments have begun talks about dividing up the southern pole's mineral spoils: these may include 48 billion barrels of oil.

Agricultural trade were liberalised, incomes in developing countries would be boosted by \$26 billion, employment in EEC countries would rise by 3m, and the American trade deficit would shrink by \$40 billion. So predicts the Australian Centre for International Economics.

Working together

Kajima, a Japanese construction group, and **Allied Properties** of Hongkong aim to build the biggest hotel and commercial complex in Hongkong. It will include the 1,100 room Wanchai Hotel and may cost HK\$1.6 billion (\$205m).

Five airlines—British Airways, Swissair, KLM, Alitalia and USAir—agreed to buy a half interest in the Apollo computer-reservation system from **Allegis**, the troubled American parent of United Airlines which has received a \$2.37 billion bid from the airline's pilots.

Japan and **China** have agreed to start talking again about an investment-protection treaty which would make Japanese companies less wary about investing in China.

Raising money



To howls of fury from small investors, **Robert Holmes à Court**, an Australian entrepreneur, sold a 40% stake in Bell Group for around A\$2.60 (\$2) a share—a 50% premium on the market price. The deal, which is under investigation, will raise A\$333m for "the great acquirer" who will still own around 6% of Bell. The buyers are the Western Australian State Government Insurance Commission and Alan Bond.

Norsk Hydro is raising \$400m through rights issues in the eight countries where shares in the Norwegian petrochemicals and metals giant are listed.

The West German government will raise DM1.46 billion (\$870m) from the sale of its 60% stake in **Viag**, an energy and metals group. That may

be the last big German privatisation this year—unless the government decides to sell Lufthansa.

D. Carnegie, a Swedish investment group controlled by Erik Penser, has sold its Fondkommission broking arm to **PKbanken** for SKr2.7 billion (\$460m)-worth of new shares in Sweden's third biggest bank. The deal reduces the government's holding in PKbanken from 85% to 65%.

Cartel-busters

Officials from the **European Commission** raided seven stainless-steel producers—Thyssen and Krupp in West Germany, Acerinox in Spain, Terni Speciali in Italy, ALZ in Belgium, Ugine of France and British Steel. They are suspected of forming an illicit cartel to try to control prices.



Britain's **Office of Telecommunications (OFTEL)** abolished British Telecom's monopoly in supplying private payphones. That should lead to more payphones in British pubs, shops and garages. Complaints to OFTEL about BT increased by 77% last year.

New Zealand deregulated its oil industry, removing price controls and import restrictions.

The **International Stock Exchange** in London has decided to allow more types of firms to act as money brokers. It hopes this will lead to lower costs for securities houses that

want to borrow stock.

People



Jonathan Cohen, the former chief executive of County NatWest, was appointed vice-chairman of another merchant-banking subsidiary of a British clearing bank—Charterhouse, owned by the Royal Bank of Scotland.

Albert Casey, who was recently appointed chairman of **First Republic**, sacked half the directors of the near-bankrupt Texan bank.

Bottom line

More air travellers than expected helped **Pan Am** to reduce its first quarter after-tax loss from \$93.6m in 1987 to \$83.3m. But the troubled American airline has still to persuade its unions to accept smaller wage packets.

Siemens's post-tax profits fell by 9% to DM602m (\$360m) for the six months to the end of March. The West German electricals giant says that its order book is picking up.

Strong sales volume and favourable exchange rates helped **Eastman Kodak's** first-quarter post-tax profits to jump by 46% to \$260m.

Financial Corporation of America's negative net worth rose 39% in the first quarter to \$226.5m.

Canadian Pacific Limited

Canadian Pacific Limited's earnings per Ordinary share increased 45% to 61 cents in the first quarter of 1988. This compares with 42 cents before extraordinary items in the first quarter of 1987. Consolidated net income in the first quarter of this year was \$183.9 million compared with \$125.4 million before extraordinary items in the first quarter last year.

EARNINGS
PER SHARE

UP 45%

Forest products, rail, bulk shipping and steel operations made the biggest contributions to the higher first quarter earnings. Increased income was also produced by the real estate and hotels sector.

Consolidated Income (unaudited)

(in millions of \$Cdn., except amounts per share)

	1st Quarter 1988	1st Quarter 1987
Transportation	\$ 82.7	\$ 56.3
Energy	29.8	39.4
Forest Products	59.0	25.0
Real Estate and Hotels	10.0	5.2
Manufacturing and Other	2.4	4.9
Discontinued Businesses	—	(5.4)
Net income before extraordinary items	183.9	125.4
Extraordinary items	—	193.3
Net income after extraordinary items	\$ 183.9	\$ 318.7
Earnings per Ordinary share before extraordinary items	\$ 0.61	\$ 0.42
Earnings per Ordinary share after extraordinary items	\$ 0.61	\$ 1.06

Canadian Pacific Limited's earnings increased sharply in 1987 and further increases are anticipated this year. Demand for pulp and paper, steel products and transportation services is strong and coal markets have improved.

For more information, please write to: Denis Keast, Director, Financial Services Europe, Canadian Pacific Limited, Southside, 105 Victoria Street, London SW1E 6QT

BUSINESS



Reuter and Herrhausen in troubled tandem

BONN

EXECUTIVES in West Germany hardly look like hardened gamblers. But two of the most important, Mr Edzard Reuter and Mr Alfred Herrhausen, are locked into a tie with the highest of stakes. For better

or worse, it will do much to shape the West German economy in the 1990s.

The two men have much in common (though not their politics—see box on next page). Mr Reuter, aged 60, is head of Daimler-Benz, the country's biggest industrial group with sales last year of DM67 billion (\$37 billion) and 326,000 employees. Mr Herrhausen, aged 58, is chief of Deutsche Bank, the country's biggest bank and Daimler's main shareholder (with a 28.5% stake). Both are eloquent, abrasive and (rare in West Germany) foes of what Mr Herrhausen calls "the tyranny of the status quo".

Part of that status quo is the ingrained tradition that "a good cobbler sticks to his last". If this is a tyranny, both Daimler and Deutsche are certainly rebelling against it. Deutsche has been branching out from banking into broader financial services—venture capital and management consultancy, property broking and mortgages. Daimler too, maker of the luxurious Mercedes cars, has diversified far beyond motor vehicles during the past three years.

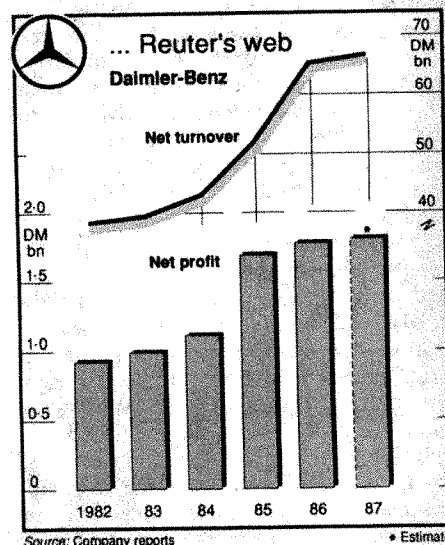
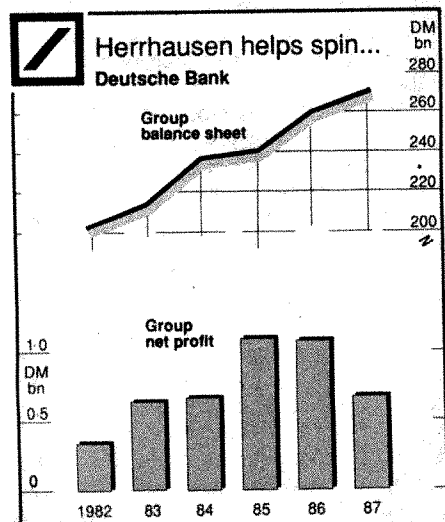
Until 1987 Mr Reuter was Daimler's fi-

nancial chief. He became the main architect of a strategy which gave the company full control of MTU (an engine manufacturer) and majority stakes in AEG (electrical goods) and Dornier (aerospace). The cost was nearly DM3 billion—a sum which hardly caused a dent in the company's balance sheet. When Mr Reuter beat Mr Werner Breitschwerdt, an engineering wizard but only a half-hearted "diversifier", for the top job last year, it was with the crucial backing of Mr Herrhausen, who is chairman of Daimler's supervisory board.

Both businesses seem to be following a common logic: banking and carmaking are global industries in which a spread of activities can help you to compete. In banking that means offering existing customers a wider range of services, like mortgages or even insurance (a field Deutsche is thinking of moving into). In the automobile business it may mean learning from, and using the products of, an electronics factory to build better cars.

That is the Reuter-Herrhausen theory. At the moment, it is an unconventional one. Most recent research suggests that companies overestimate how much they can learn from companies they acquire, and how much they can gain from much-vaunted "synergy". The Daimler group does not share these concerns and is carrying on regardless. Its subsidiary AEG has just paid \$290m for the industrial-automation system of an American company, Gould. This represents another step towards "the factory of the future" for Daimler, and gives it more manufacturing capacity in America. But why is Daimler so firmly committed to diversification?

Mr Reuter had a twofold strategy. He



Chalk and cheese

BONN

"BRILLIANT"—but a bit too independent" was Lenin's verdict after meeting Mr Edzard Reuter's father Ernst, a left-wing leader who went on to survive Nazi torture and exile to become mayor of Berlin.



A lot of conservatives say much the same today about the son. Mr Edzard Reuter, born in Berlin in 1928 and raised in Turkey during the war, is a passionate

Social Democrat who makes managers squirm with his lectures about preserving the environment and creating jobs. That he has become head of the group which makes luxury Mercedes cars and a lot of military hardware is one of the minor miracles, and supreme ironies, of post-war West Germany.

Because of his party affiliation Mr Reuter was passed over at least twice for the top job at Daimler, which he joined in 1964 and stuck to despite other tempting offers. At one stage, when promotion was in the offing, he was even asked by the company to sign a statement confirming he supported the country's democratic order, an odd request indeed given his family history. He eventually became boss because there was no longer any denying he had the nimblest of brains and because his vision of how Daimler should develop convinced the mightily influential Mr Alfred Herrhausen.

Politically the two are poles apart. When Mr Reuter recently charged western leaders with a "shocking lack of economic competence", few doubted that he had Mr Helmut Kohl, the Christian Democratic chancellor, in mind. Mr Herrhausen is a friend of Mr Kohl and advises him on economic matters—though the impact of his counsel on government policy is hard to discern.

Despite that broad difference the two executives are said to have high respect for one another. While Mr Reuter is a financial wizard as well as an industrialist, Mr Herrhausen is an industrialist who came relatively late to banking. Born in Essen in 1930, he worked for a big utility, RWE, before moving to Deutsche Bank's managing board in 1970. He has not let his industrial connections slip, and at one time even toyed with the idea of seeking the chief executive's job at Daimler-Benz, which may help explain his fascination with the company now.

Mr Herrhausen was Deutsche's crown prince almost from the start. He became a co-speaker, in effect one of the two chairmen, of the bank's managing board in 1985. This month he passes a new milestone. The other speaker, and Mr Herrhausen's long-time mentor, Mr F. Wilhelm Christians, is retiring and will not be replaced. That leaves Mr Herrhausen alone at the top, a position of power in German business not seen since the days of the legendary Hermann Josef Abs who rebuilt Deutsche after the war.



is one of four partners. Even if that condition were met (talks have been going on sporadically for many months) Daimler also faces tricky negotiations with its family partner at Dornier.

Some critics claim that Daimler's board has been so busy trying to bring together its new empire that it has neglected its core activity. Similar accusations have been made at Deutsche, where some board members have argued that working on the supervisory boards of Daimler and other companies is a distraction from the main work at the bank.

Daimler's executives deny the charges, but the car business has been giving them an unusually bumpy time. The new mid-range Mercedes series (200D to 300E) had teething troubles; arch-rival BMW (no diversifier despite political pressure in its home state of Bavaria to get involved in MBB) has produced a successful new luxury 12-cylinder limousine which even Daimlerites reluctantly admire. Moreover the West German car market is faltering. Daimler's 1988 production may fall below the 598,000 figure it achieved last year.

There are successes to offset these disappointments. The group's net profit for 1987 held up at around 1986's record of DM1.8 billion thanks to West Germany's opaque accounting procedures. These figures understate Daimler's true earnings power. Mr Reuter has launched a cost-cutting and reorganisation campaign with the help of McKinsey, a firm of management consultants. A new model Mercedes is on the way which, the company hopes, will wrest back the initiative from BMW. Last but not least, Mr Reuter is respected by his fellow executives as his predecessor was not.

That said, Daimler is not just any big company. It is the flagship of West German industry, just as Deutsche is of banking; the three-pointed star is a symbol of excellence the world over. Like it or not, Mr Reuter's strategy puts the West German economy self on trial. Its failure would mean a loss of prestige abroad and a blow at home far greater than AEG's financial torment at the start of this decade.

That would inevitably reflect back on Deutsche—and not just through Daimler-Benz's share price. Mr Herrhausen has identified himself closely with Daimler's new course by putting Mr Reuter in the top job, selecting Mr Reuter's heir-apparent for the early 1990s (Mr Helmut Werner, brought in from outside the company), and by helping to mould Daimler's new managing board. Deutsche and other big West German banks are often criticised for their overweening influence on West German industry. When the results are good the criticism tends to fall flat. It will be a different matter if so spectacular a move as Daimler-Benz's diversification fails.

wanted in-house expertise in the increasingly important field of electronics; and he thought the group needed a broader spread of high-tech activities lest car sales flag. This suggests there is a tension built into the strategy of diversification. If AEG is supposed to help Daimler build better cars, then Daimler should integrate its activities into the car-making business; if it is to be part of a separate industrial group, then Daimler should leave AEG alone. So far, Daimler has tended to leave it alone.

AEG is much the biggest of the group's acquisitions with sales of DM11.5 billion and (in marked contrast to Daimler hitherto) a wide range of products from defence equipment to washing machines. In the two fields closest to Daimler, automotive electronics and factory automation, AEG lags behind other major competitors like Bosch and Siemens.

Daimler could help AEG catch up by giving it some business which would otherwise have gone to outsiders. But it has to weigh

the costs in cash and time. And its freedom of action has been limited: under West German company law it is hard to override the wishes of dissident shareholders even if you own 60% of the shares. That, though, may change. Daimler is in the process of raising its stake in AEG from around 60% to at least 75%.

Daimler would like to raise its 65.5% stake in Dornier too, but that will be tough. Most of the rest of the shares are held by the Dornier family, which does not want to sell. That matters because the family regards Dornier as a pearl in its own right, while Mr Reuter sees it mainly as a link in a West German (or European) aerospace chain.

Mr Reuter reckons that Dornier (sales last year: DM1.6 billion) and its local aerospace rival MBB (sales: DM6.2 billion) must get together if they are to match international competition. To help achieve that Daimler is ready to buy into MBB, but only if the government first fully covers the financial risks of the Airbus project in which MBB

Leading up the garden path?

Financial markets follow every twist and turn in America's index of leading economic indicators. How good are such indicators as a guide to what is really likely to happen?

THE slump in America's index of leading indicators in late 1987 triggered fears of recession. The index has since rebounded: good news for growth, bad news for inflation. In contrast, Britain's index of longer leading indicators has been falling steadily since the middle of last year, suggesting a slowdown in 1988. How much of an advance are these magic indices on the entrails of birds?

Financial markets pounce on each indicator the second it is released. While statistics such as industrial output and GDP simply reflect the current state of economic activity—or, more usually, that of several months ago—some indicators have a past record of providing clues about the future. The value of these so-called leading indicators (eg, building starts, new orders, surveys of business expectations and financial indicators) is that they tend to start falling well before the peak of an economic cycle is reached and start rising before the economy bottoms.

Leading indicators can thus play a big role in economic forecasting. There is no point in a forecaster having a superb model of how an economy works if he is in the dark about the current state of the economy—if he can't even forecast the present. Long delays in the publication of GDP figures and the possibility of huge revisions means that the recent past must itself often be estimated. The timing of turning-points is one of the least reliable parts of forecasting. If, unbeknown to the economist, such a change is already underway as the forecast begins, this will render the exercise useless. Leading indicators can fill the gap.

Many industrial countries publish their own leading economic indicators. America's index includes 11 individual series ranging from share prices to stockbuilding. The OECD has developed a system of leading indicators for 22 of its member countries. The composition varies from country to country, reflecting differences in statistical systems as well as in economic structure. Individual indicators are chosen as follows.

First, there must be a good economic reason for thinking that a certain indicator might lead the economic cycle: a statistical correlation by itself is not good

ECONOMICS FOCUS

enough. Second, the length of time (or "lead") by which an indicator precedes turning-points in output should be fairly constant. And third, indicators should be published with minimum delay and be subject to little revision. The indicators which the OECD finds to be most often the best predictors of the business cycle are surveys of business expectations and monetary and financial indicators, such as stockmarket prices and interest rates.

To combine these diverse series requires some statistical juggling. Some series, such as interest rates and stocks, need to be inverted so that they move in the same direction as industrial production. Next the secular trend is stripped from

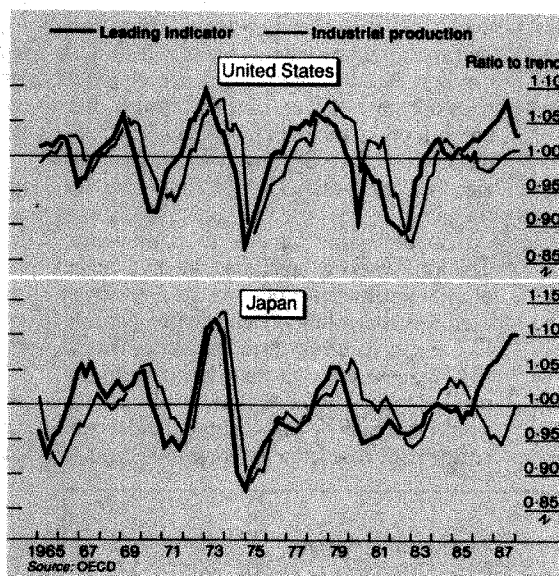
at how well they tracked industrial production during the course of each cycle.

Generally, the OECD concludes that its composite leading indicators have performed well (the chart compares leading indicators and industrial production, both relative to their trends). The indicators have rarely failed to signal turning-points. In most countries they lead industrial production by about six months; in Britain the lead is as long as 13 months.

The snag is that when the leading indicators are first published some of the components are unavailable or are only provisional, so the index may subsequently be revised over the coming months. The OECD publishes its indices as soon as at least 40% of the component indicators are available. This incomplete index, in first-published form, is the one used most for forecasting. As a result, studies that look at the predictive power of the completed series can be too flattering. Oddly, though, the OECD finds that in most countries there is little difference between the predictive power of the incomplete leading indicator and the final series.

Despite this close historical fit between leading indicators and industrial production, it is difficult to spot turning-points on the basis of the composite indicators alone because average leads give only a rough guide. The OECD suggests several further measures which may help: the six-month change in the index of leading indicators, the ratio of the leading indicator to industrial production, and the ratio of the six-month change in the leading indicator to the six-month change in industrial output. For example, the OECD's leading indicator for America did not itself reach a trough until November 1982, only a couple of months before the actual low in industrial production in January 1983. However, the ratio of the six-month changes started to signal the trough as early as December 1981—ie, when the ratio rose above 1.0. Between 1960 and 1983 these derived measures have successfully predicted all cyclical turning-points. They have also given a number of false alarms.

So when is the next recession? After rising almost continuously since the early 1980s, the OECD's leading indicators have fallen in most of the big economies since mid-1987—mainly because of the fall in share prices. Two of the three derived measures also signal that the peak of the cycle is past. A slowdown in growth looks likely next year . . . perhaps.



each indicator to reveal purely cyclical movements. The OECD then smoothes the series to eliminate erratic monthly movements and adjusts them so that all series have cycles of similar amplitude. This is to ensure that an indicator with a pronounced cycle is not given undue weight. Finally, the series are combined with equal weights in a composite index.

How good is the forecasting record of leading indicators? In a study* last year the OECD examined the accuracy of its own indicators in predicting movements in industrial production. It looked both at their ability to predict turning-points and

* OECD leading indicators, R. Nilsson. OECD Economic Studies No. 9.

BUSINESS

Japanese tourism

Broadening the mind

TOKYO

FEW things respond more quickly to exchange-rate changes than international travel. So one of the fastest-changing businesses over the next few years should be Japanese tourism. This week provides a good opportunity to test the changes so far: four public holidays between April 30th and May 5th straddled a weekend, and 51m people took advantage of that rarity in Japan—seven days off work—to have a holiday. For the overwhelming majority, that meant a holiday in Japan. But 270,000 went abroad, 25% more than at the same time in 1987. Hawaii, Hongkong and the west coast of America were the most popular destinations, each attracting 40,000-50,000 free-spending yen-bearers.

Foreign travel is likely to be one of Japan's growth industries in the 1990s. Or so the government thinks. In the mid-1980s Japan was running an annual deficit on tourism of around \$5 billion. In 1986 the government said it hoped this figure would rise to \$10 billion by 1991 and that the number of Japanese travelling abroad would double to 10m or more. This would mean maintaining a 20% annual growth in the volume of international travel.

At the moment, it is managing to keep up that pace (see left-hand chart); in the year to March 1988 the tourist deficit hit \$9.7 billion. More days off, higher disposable incomes and fashion are encouraging more Japanese to take foreign holidays. The strong yen makes it cheaper for them once they are there (and opens their eyes to how expensive goods and services are at home). The Japanese overseas-travel market is now worth at least ¥2 trillion (\$16 billion) a year



A package waiting to be unwrapped

and accounts for about one-fifth of the country's holiday business.

Although more Japanese than ever are travelling abroad, the absolute numbers are still small. As recently as 1978 the government still imposed restrictions on overseas travel. It was not until 1986 that one landmark—5m trips abroad—was reached. Last year the total was 6.8m. This year it should top 8m. As only four out of five of those trips are for holidays, that still means that barely more than 5% of Japanese take a holiday abroad. Two Britons in five take a foreign holiday a year; 11% of Americans do the same.

So the scope for growth is immense. The long-working Japanese take an average of only seven days' holiday a year, which is even less than they are entitled to. Jardine Fleming, a securities firm, estimates that if the Japanese took all their holiday entitlement, then the overseas-travel market would increase by one-quarter. And if the entitlement rose from its present average of

ten days a year to the American average 19 days (let alone the West German one 31 days), the market could double.

What the Japanese lose in days spent abroad, though, they make up for in cash spent there. The average tourist spends nearly ¥100,000 (\$800) on shopping on each foreign trip. This is by far the highest spending per person by any nation's travellers. Japanese visitors to Hongkong are said to leave Japan with an average of 33lb of luggage and return with 66lb.

These big spenders are predominantly young—especially single working women, who account for 18% of all Japanese tourists. They head for the shops and sand of Hongkong, Hawaii and California, while the next biggest group of tourists, men in their 30s, head for the sex-and-sand-traps of South-East Asia.

Young, more adventurous, tourists are slowly changing the shape of the business in Japan. At the moment, it reflects the old days in which massed ranks of Japanese tourists shuffled obediently around foreign cities. Package tours are the mainstay of the industry, and the top seven companies have an 80% share of the market (see right-hand chart).

One-third of all tourist trips abroad are on package holidays; other kinds of group tours account for nearly all the rest. The Japanese tourist abroad can fly out on a Japanese airline, stay in a Japanese hotel, play golf on a Japanese-owned course, and shop in a Japanese-owned department store anywhere from Singapore to San Francisco.

Independent travel is fashionable among the young, but only for the wealthy. Air fares from Japan have not fallen to reflect the yen's rise. A return ticket from Tokyo to Hongkong costs ¥182,600 if bought in Tokyo; if bought in Hongkong it costs the equivalent of ¥83,700. On the Tokyo-Los Angeles route, the comparable prices are

The high-yen travellers

Japanese overseas travellers

Destinations, 1986*	
United States	1,681,071
of which: Hawaii	944,000
South Korea	791,011
Hongkong	727,219
Taiwan	696,686
Singapore	404,278



Sources: Ministry of Justice; Prime Minister's office; Jardine Fleming

Travel agency market

Market share, 1987

JTB 34

Kinki Nippon Tourist 14

Nihon Travel Agency 12

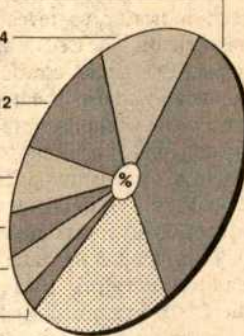
Tokyu Tourist 7

Nippon Express 5

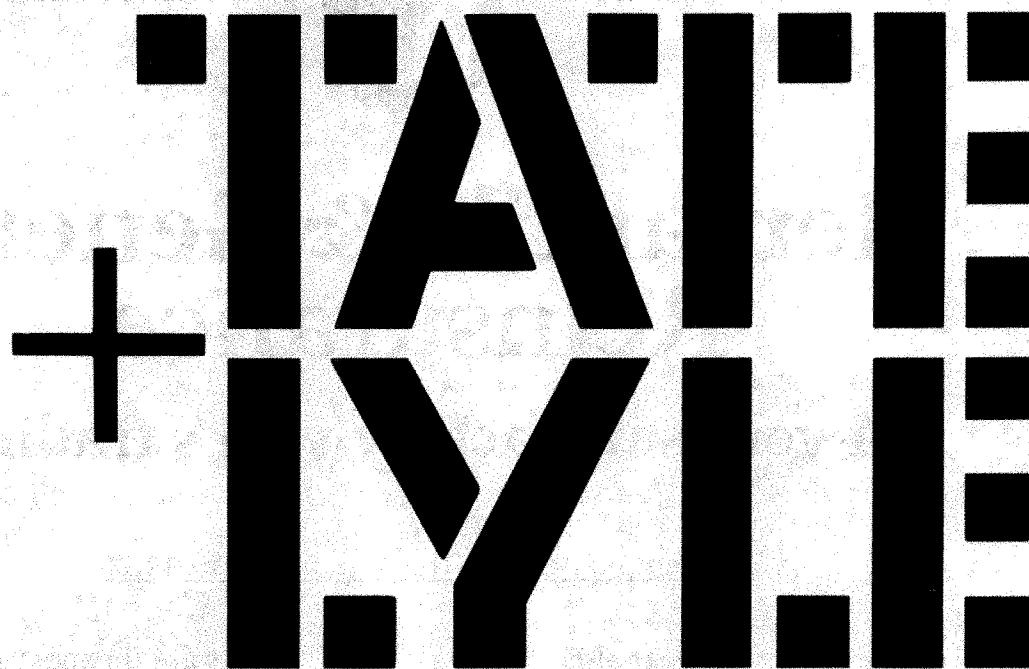
Zenkaku Nokyo 5

Meitetsu World Travel 3

Other 20



*Some figures not yet available; in 1985, W Germany was fifth, China sixth



“ We have increased the price of our previously announced tender offer for Staley Continental to \$35 per share. The acquisition is an important move in an overall strategy to develop our worldwide sweetener business ”

Dividend and Earnings up

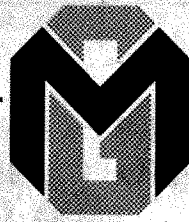
- Significant improvement in UK sugar refining
- Redpath Sugars results remain very satisfactory
- Sugar trading and malting businesses achieve substantially higher profits
- Interim dividend increased by 11%
- Earnings per share up 16%

These Unaudited Interim Results do not constitute full financial statements. Details of the Interim Report for the 26 weeks to 26th March 1988 are being mailed to shareholders.

Further copies may be obtained from: C P McFie, Secretary, Tate & Lyle PLC, Sugar Quay, Lower Thames Street, London EC3R 6DQ.

Unaudited Interim Results

	1988 26 weeks to 26th March	1987 26 weeks to 28th March
Pre-tax profits	\$43.8m	\$40.2m
Interim dividend per \$1 ordinary share	10.0p	9.0p
Earnings per \$1 ordinary share	35.2p	30.3p



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Salient points from the Annual Report 1987

- * Group profit for the year after taxation rose to £50.6 million.
- * At constant rates of exchange General premium income increased by 7%, Life annual premiums by 16% and Continuous Disability premiums by 28%.
- * Group net premium income for 1987 was £603.4 million.
- * General results are now showing a much improved position with a further increase in our operating surplus.
- * Life results are the most successful in our history. However because of uncertainties in regard to AIDS the post-tax transfers from our Long-Term Funds have been maintained at a similar level to those of last year.
- * Our solvency ratio at the end of the year was 67%. Total Shareholders' Funds at that date were £167.7 million.
- * Total Group assets now exceed £1850 million.

Copies of the Annual Report 1987, containing the Chairman's Statement in full, and a Review of Operations for the year, can be obtained from the Secretary.

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¥330,800 and ¥259,100.

With a restricted number of flights in and out of Japan (partly because airport space is tight; partly because government regulation is abundant), there is little room for discounters. But if foreign travel is to double in the next three years, that must change—which would seem to offer opportunities for foreign providers of cut-price airlines. The transport ministry's suggestion for "liberalisation" is that its three client airlines (Japan Air Lines, All Nippon Airways and Toa Domestic Airlines) should increase their international charter business.

Can such little-Japanism last? Many think the growing demand for travel by the young Japanese, who are more price-conscious than their parents, will force the pace of deregulation and open the market to foreign competition. And at the same time, many of Japan's powerful department-store, railways and hotel groups (Seibu, Tokyu and Hankyu) are getting into the tourism business.

Information technology is increasingly making the traditional travel agency obsolete. Expertise in computerised marketing and distribution to niche markets is giving companies a competitive edge in the travel business. The department-store groups already have these skills. It may not be long before they charter their own airliners and begin to transform Japan's foreign-travel industry.

Mexican privatisation

Getting down to business

MEXICO CITY

THE dying months of most Mexican administrations have been times for grand nomic gestures which usually turn out to grand mistakes—like President Jose Lopez Portillo's nationalisation of the banks in 1982. The final few months of President Miguel de la Madrid's administration may also be a time for a grand gesture, but this one could be a success. It involves denationalisation.

The Mexican government has long been saying that it wants to sell off public-sector enterprises. But with a few exceptions—for example, the Presidente hotel chain, flagship of the government's tourism interests—progress has been slow. President de la Madrid boasts that he inherited 1,115 public enterprises in 1982 and by 1987 had cut the number to 400. But most of that reduction came from the dissolution of paper companies, the merger of little firms, or the transfer of companies from federal government to state governments and to government-affiliated unions. The impact of all this

The taxman counteth

TOKYO

IN MOST rich countries top rates of income tax are falling like trousers in a French farce. Not in demure Japan, where the top marginal rate of tax has been cut only to 60%, and it is applied to receipts from property sales that in other countries would not be regarded as income. Recent figures show the huge sums that Japan's super-rich are meant to pay to the taxman.

The property business is the place for rogues and riches. Some 77 of Japan's 100 top earners last year were involved in property deals, mostly around Tokyo. Four of the ten cases of corporate-tax evasion also involved property firms.

The man who reported the highest earned income in 1987 was Mr Hajime Kitame, the 53-year-old president of a timber company. Thanks to the sale of a 1,500 square-metre plot of land in front of the bullet-train station in Yokohama and other property deals, he declared an income of ¥6.7 billion (\$54m). His income-tax bill, ¥2.1 billion, may have been the highest in the world last year.

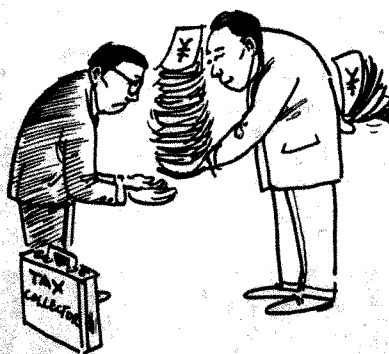
Tax officials say that more than

111,000 Japanese stumped up at least ¥10m each in income tax last year—23,000 more than in 1986. Of these, 88 were members of parliament, though only one, Mr Juro Saito, made the top-100 list. His tax bill was ¥543m, after selling 283 square metres of land in Tokyo for ¥3.2 billion.

The first 16 in the list of the top 100 taxpayers all made their money from property development. The first industrialist is Mr Konosuke Matsushita, the 93-year-old founder of the Matsushita electronics empire, who comes in 24th with ¥731m, followed by Mr Shoji Uehara, chairman of Taisho Pharmaceutical, at 28th with ¥661m. Only 13 businessmen outside the property world made the top 100.

With these high tax rates in Japan, it is not surprising that tax evasion is a national pastime, and that declared income and real income are not necessarily the same thing. The taxman says that the Japanese evaded a record ¥21.5 billion in income, inheritance and corporate taxes in 1986. And that would be just the ones that were found out.

Top of the corporate black list was Mr Masao Kobayashi, a 60-year-old moneylender. The taxman says he tried to evade ¥1.7 billion in taxes. Many people caught dodging tax were doing so to hide capital gains made on the stockmarket. The worst alleged corporate offender was Dai-ichi Building, a Tokyo property firm that is said to have dodged ¥923m on its property dealings. Little wonder that the taxmen want to shift the burden of the country's tax system from direct to harder-to-dodge indirect taxes.



on the federal budget was small; so was its effect on government payrolls.

As in other countries, the government wanted to sell its worst companies to the private sector first, while businessmen wanted to get their hands only on the best ones. Mexico added two problems of its own: a shortage of local capital, which meant that the most likely bidders for many companies were foreigners, and the close ties between the ruling party and the trade unions. Featherbedding at state-owned companies has long been part of the price the government pays for union support; breaking labour contracts is politically difficult.

Despite these problems, Mr de la Madrid is using his last year in office to reduce the government's role in the economy. So far this year he has given the go-ahead for the purchase by Chrysler and Navistar of a

controlling interest in Diesel Nacional, a failing lorry builder; Japan's Kobe Steel is acquiring control of a joint venture in which it had been the government's minority partner; and private Mexican investors have bought a smattering of smaller state companies, including shipyards and sugar refineries. All the same, the president's admirers said he needed a "spectacular" operation to convince sceptics of his commitment to privatisation. The operation has just been mounted.

On April 13th 7,000 workers at Aeromexico, a state-owned airline, walked out on strike in protest about the cancellation of uneconomic routes and the sale of 13 airliners. Three days later the government responded by declaring the money-losing company bankrupt; Aeromexico's employees were sacked and its remaining 28 jets put



up for sale. At least a dozen cities were left without an air service. Union leaders angrily asserted that Aeromexico's financial troubles were caused by its government-appointed managers.

Several fledgling regional carriers are emerging from the wreck, so the airline's reservation facilities, new jets and busiest routes may be revived. But the old Aeromexico, long a symbol of loss-making state enterprise, is no more.

Just after this forced sale, the government put through a second, less controversial (but more expensive) deal which might be a model for future privatisations: the sale of a majority stake in Compania Minera de Cananea, a copper company. This privatisation used debt-equity swaps to sell a state company for the first time on a large scale. Grupo Protexa, a family-owned conglomerate based in Monterrey, bought \$910m of Mexican government foreign debt at a discount on the secondary market, at a cost of around \$450m. It then used the \$910m of assets it owned to buy the copper mine, Mexico's biggest and one of the ten largest in the world. The most unusual aspect of the deal was that the group obtained foreign financing from a consortium led by First Chicago: it is a long time since private foreign banks have lent large sums voluntarily to anybody in Mexico.

What might be next? Mr de la Madrid has said certain enterprises are untouchable: Petroleos Mexicanos, the Comision Federal de Electricidad (the national power utility), and Ferrocarriles Nacionales (the national railway). But his appointed successor, Mr Carlos Salinas de Gortari, is talking about privatising the telephone company. Other candidates include Mexicana, the country's other big airline; Fertimex, a fertiliser manufacturer; Sidermex, Mexico's biggest steel company; and Pipsa, a company with a politically sensitive monopoly on newsprint supplies. Mr de la Madrid and Mr Salinas have long preached the virtues of a state business sector that is "strong, but not obese". Mexico's state-owned industry is at last slimming down.

Meanwhile in Brazil . . .

SAO PAULO

WHILE Mexico is offering to sell state companies to international investors, Brazil is putting up more defences against foreigners. On April 28th an unholy alliance of left-wing politicians, businessmen and military men pushed legislation through congress limiting foreign ownership of mining companies (including those already in operation) to under 50%. The law still has to be given a second reading. But barring an upset in the balance of power, it will make it on to the statute books. Foreigners with subsidiaries are likely to be given five years to reduce their stakes—quite a job since 470 foreign companies own the rights to 38% of the country's mineral deposits.

That is not the only new Brazilian protectionism. Local shippers will be re-

served 50% of the country's foreign traffic regardless of the measure's effect on freight costs. And congress passed a law prohibiting so-called risk contracts—deals struck between the state oil monopoly, Petrobras, and foreign companies, allowing foreigners to drill for oil at their own risk in exchange for royalties on any discoveries.

In all this, Brazil is rowing against the tide. The cost to the country is already apparent. On the same day that congress passed the mineral legislation, the country's second debt-equity conversion auction was held in Sao Paulo. The amount of debt bought for conversion on to the stockmarket dropped from the previous auction's \$1.8m to \$200,000—a clear sign of the growing reluctance of investors to put money into Brazil.

Television in America

Broadcast blues

NEW YORK

BEFORE coming to television, the president of NBC, Mr Robert Wright, made toaster-ovens and washing machines for NBC's parent company, General Electric. So he knows something about mature, declining markets. Now he is trying to use those skills to prepare America's biggest television network for tougher times ahead. This week he bought a toehold in a cable-television

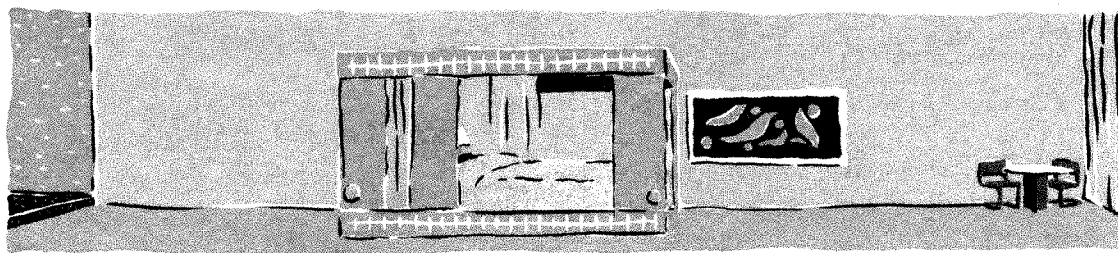
company called Tempo. Because it is stealing away NBC viewers, cable is at the root of the network's problems. Mr Wright reckons it is also a part of the solution.

Taken together, the big three American networks lost 9% of their audience last year, over 6m viewers. The number of homes connected to cable, meanwhile, grew to over half of those with television. While some new cable customers simply use it to watch network shows, many watch special-interest programmes ranging from fishing to first-run movies. The three networks' share of the television audience has declined to around 70%. Mr Wright thinks it could de-

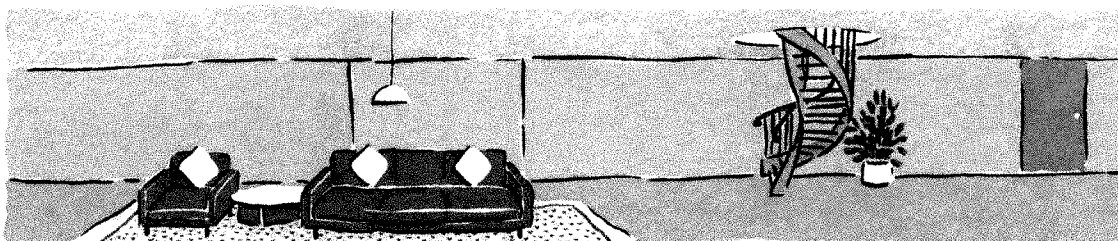


O Tempo! O mores!

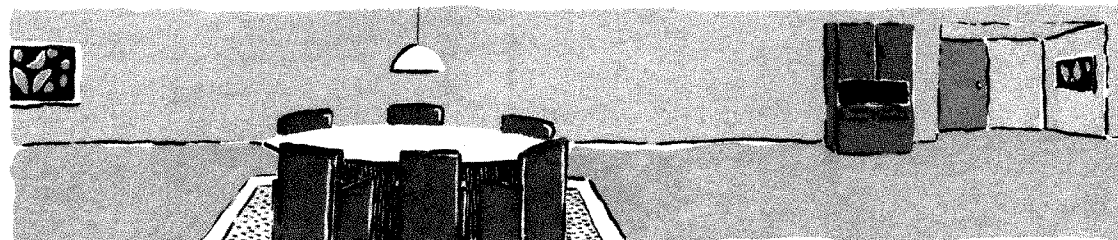
BED ROOM



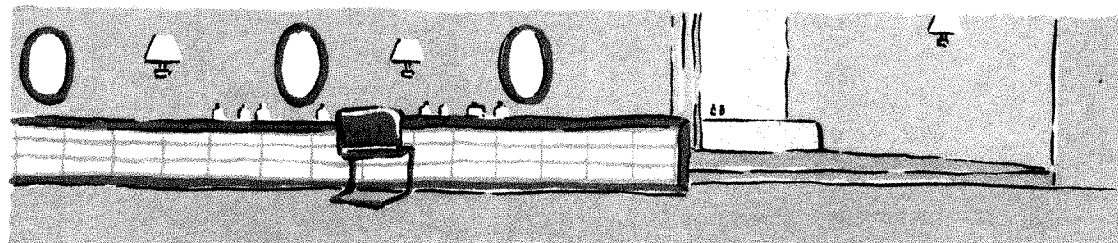
LIVING ROOM



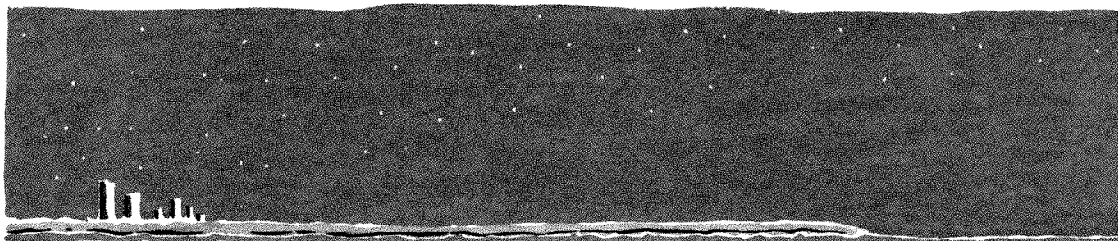
DINING ROOM



BATHROOM

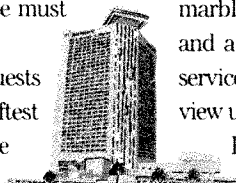


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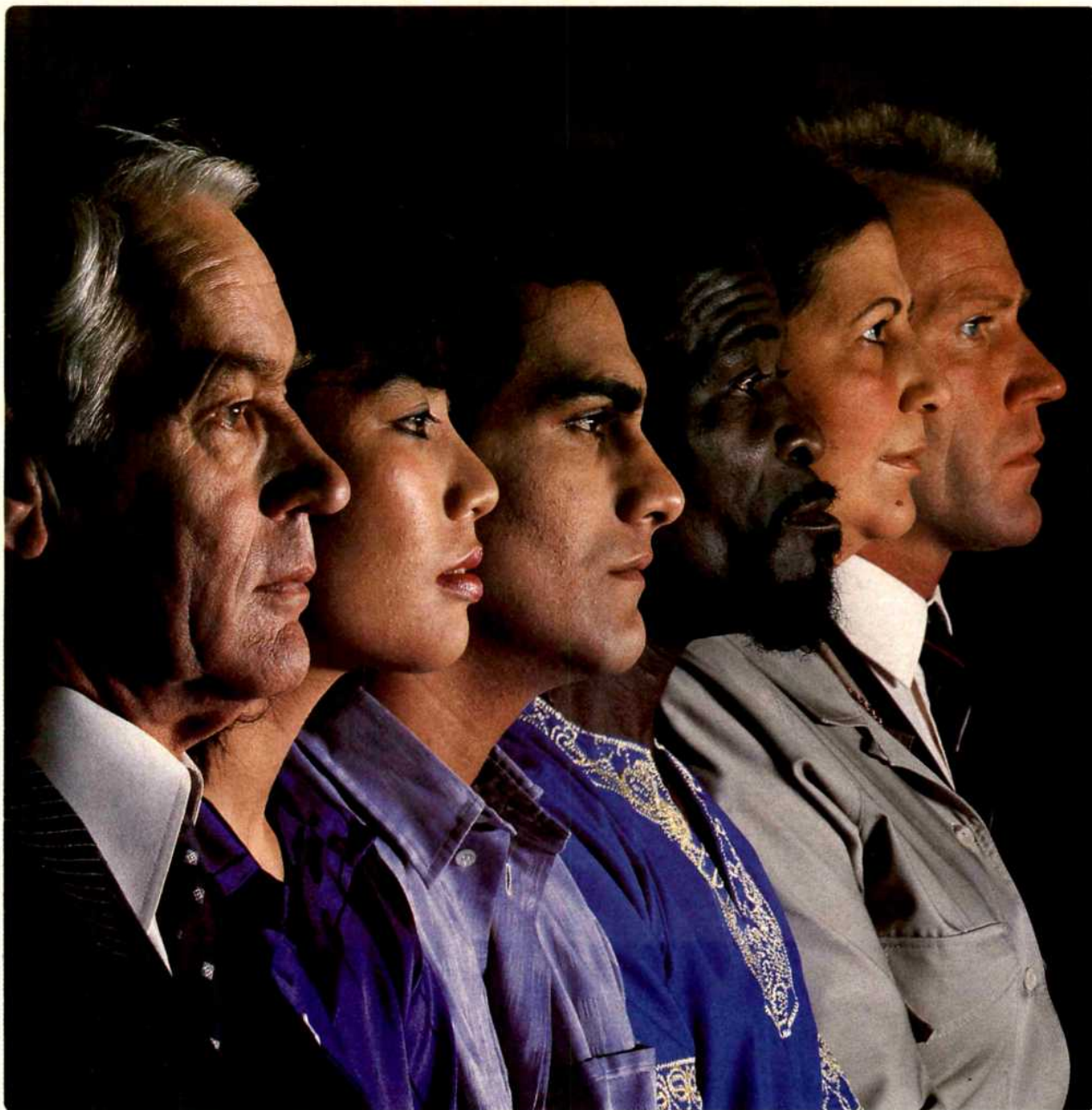
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cline to as little as 60%.

His counterparts at CBS and ABC are not so pessimistic. CBS's Mr Larry Tisch thinks the networks' decline is over. Having cut costs and sold off diversified subsidiaries in publishing and record-making, he now expects smoother sailing. ABC's Mr Tom Murphy already owns most of America's biggest cable company, sports specialist ESPN. So Mr Murphy has devoted his time and money to increasing ABC's share of the prime-time market from third (where it languished for four years) to second, a position it recently wrested from CBS.

Mr Wright has more scope to think about diversification. NBC tops the popularity polls, and thinks profits this year will be at least \$300m—more, probably, than its two rivals combined. So in addition to mass-market programmes like "The Cosby Show" and "Cheers", NBC is experimenting with programmes aimed at market niches. It is producing a children's show for Disney's cable channel, and starting to produce movies for the cinema (though its first effort flopped). The acquisition of Tempo will give it new opportunities to develop narrowcasting skills—and to learn how to use them to support the network's broadcasts rather than to compete with them.

At a price of \$20m, Tempo cost NBC little more than a year's production of a prime-time drama. With 12m subscribers, Tempo is only one-quarter of the size of cable industry leaders like ESPN or Mr Ted Turner's Cable News Network. But if NBC can make Tempo grow, it should also be able to reduce the decline in its network audience.

Winning new cable viewers, though, is only half of the problem for NBC. It must also work out how to do that without cutting into its own broadcast audience. The backbone of NBC's business is over 250 "affiliated" independent television stations which broadcast NBC's programming in return for a slice of the advertising time and money. While switching viewers over to Tempo may be a zero-sum game for NBC, it is damaging for the affiliates. ABC's affiliates screamed blue murder when ESPN grabbed audience share by signing a deal to cable-cast football games. NBC's plan boils down to an assertion that there is synergy between cable and broadcast television. It is not saying how.

Computer reservation systems Booking fast

WASHINGTON, DC

WHILE governments fight shy of cross-border airline get-togethers, carriers are finding another way to become transnational companies: they are investing in one another's computer reservation systems

Room service

HONGKONG

HOTELS in Hongkong are crowded, noisy and making pots of money. Plenty of people are building new ones; 20 hotels are under construction, which would take the total to 82 in 1990; a Japanese construction group, Kajima, has just announced a plan with Hongkong's Allied Properties to build the biggest hotel-plus-commercial complex in the colony. With China's resumption of sovereignty in 1997 so close, is all this activity wise?

The economics of hotel building suggests not. It will take around three years to get a hotel up and running with habitable guest rooms, restaurants and a health club. With an occupancy rate around 75%, the initial cost might be recovered within five-eight years. After that, an occupancy rate of 55% might be

enough to cover running costs.

So, if you plan a Hongkong hotel now, when tourism is rosy, you will need it to be three-quarters full as 1997 approaches. After 1997 nobody knows how many people will be coming to the ex-colony on business or for cheap shopping. Optimistic hoteliers think that Hongkong's tourist boom (the number of visitors rose 21% last year) will continue after 1997 because its merit as the gateway to China will improve, and its attraction as a shoppers' Shangri-la will remain. Shopping is important. The biggest increase in visitors last year came from bargain-happy Japanese: around 40% more of them.

The hotel people need to be optimistic. When their business is good it is very, very good—and when it is bad it is dreadful. Fixed costs represent a high proportion of total costs. With occupancy rates now averaging 85%, Hongkong hotels are making big profits. The Mandarin Oriental group has just reported a 72% increase in profits to HK\$245m (\$31m) in its latest year.

When the market slumps, however, there are sharp losses. You cannot sack 35% of the bellboys and waiters if occupancy rates fall 35%. Leaving the business is laborious and expensive, so oversupply can linger. Hence the tales of woe from Singapore, where too many hotels were built in response to early signs of rising demand; and from Sri Lanka where fear of two-legged tigers is keeping tourists away.



(CRS), the airlines' electronic booking forms. In the first big deal, four European airlines and an American one have paid \$500m for a 49.9% stake in a system owned by Allegis, the parent company of United Airlines. More deals are likely.

CRS became the main method of ticket distribution for airlines in America during the early 1980s after five carriers (American Airlines, United, TWA, Eastern and Delta) set up computer systems to provide travel agents with terminals on which to book tickets. CRS quickly became more than just a way to dominate travel-agent sales. It became a business of its own—and a profitable one.

The biggest and second biggest systems are American Airlines' Sabre and United's Apollo. They make their money by renting out space to airlines and other companies (for example, hotels and car-rental firms). These companies sell their services through the system and pay fees for each service booked. The fancy software in the system

also helps airlines juggle their fares to maximise loads and revenues; for instance, by predicting how many seats to sell at a discount and how many to keep back for late-booking business travellers who pay full fares.

After saturating the American market, the CRS operators looked abroad, hoping to export their services round the world. Those hopes have been dashed. British Airways, for instance, refused to allow travel agents to use Sabre to sell its tickets in Britain. Instead the European carriers formed two rival systems, Galileo and Amadeus. At the same time two CRSs were set up in East Asia: Singapore Airlines, Thai International and Cathay Pacific have formed Abacus; Qantas and Japan Air Lines are setting up one called Fantasia. Meanwhile American Airlines has installed 1,800 Sabre sets in the travel-agent franchises of Japan's All Nippon Airways.

Some of these fledgling regional CRS

BUSINESS

now want to take on the Americans worldwide. The four European partners in Galileo—British Airways, KLM, Swissair and Alitalia—together with an American airline, USAir, have just bought nearly half of Apollo, a system which is compatible with their own Galileo. Apollo's owner United (which does not fly to Europe) was a founding partner of the Galileo system and provided it with software from Apollo. The \$500m price which the five airlines have paid for their 49.9% stake in Apollo makes the bigger Sabre worth about \$1.5 billion, according to some estimates.

The partners in the other European CRS, Amadeus, include Lufthansa, Iberia and SAS. It has also selected American software—from Texas Air's SystemOne. IBM is rewriting the software of the American system for the European venture. Amadeus and Abacus, one of the East Asian systems, are meanwhile planning to invest in each other's systems and swap CRS coverage. So, too, are Abacus and Pars (a CRS now jointly owned by TWA, its originator, and North-

west Airlines).

This emerging global cross-investment is not what the American CRS operators had in mind when they decided to venture abroad. United Airlines (like American Airlines) thought that it could singlehandedly cover the world with an electronic sales distribution system. But the new strategy fits in better with the restructuring of United Airlines's parent, Allegis.

Allegis has sold its Hilton International and Westin hotel chains and its Hertz car-rental business to focus more closely on its core airline business. The sales helped it gain "neutrality" as the owner of a CRS that offers rival hotel and car-rental bookings. Now, by selling nearly half of its CRS business, United has gained more neutrality. With that, its system could become more widely accepted.

American Airlines is still trying to make its Sabre the international standard. It wants the American government to take action against British Airways for refusing to let Sabre be used to sell BA tickets in Britain.

The American government could revoke its approval of a British Airways-United Airlines code-sharing deal—a CRS gimmick which involves both airlines using a common flight number on connecting services, although passengers still have to change aeroplanes. The American government could also hold up approval of the European investment in Apollo. The government, though, seems reluctant to do either.

Global CRS links are quickly spawning other co-operative (and lucrative) arrangements among their many members. British Airways and United are planning more than just code-sharing, including joint marketing of their services. Lufthansa will train pilots for Iberia, one of its Amadeus partners. And SAS and Thai International are forging new traffic links in Bangkok and Copenhagen. Through CRS, such partnerships may eventually lead to international links between airline companies which most governments are currently blocking on the grounds of nationalism.

Not sporting

LIVERPOOL Football Club has just won its ninth English soccer championship in 11 years. All right-thinking people will trust that Mr Peter Sutherland, the EEC's commissioner for competition, will not conclude that this is tantamount to a "dominant position" within the meaning of Article 86 of the Treaty of Rome. In other respects, however, Brussels should keep an eye on Liverpool, and every other professional soccer team in Europe.

The problem is—you guessed it—1992. Once the European single market, of blessed anticipation, becomes fact, all EEC nationals will have the right to work in any country of the Community. This has terrified soccer clubs who think that rich Italian and Spanish clubs will thereupon snap up all the best players. Italian clubs at the moment are limited to two foreign players in each side, but will pay oodles for stars; Juventus of Turin (owned by the Agnelli dynasty) paid Liverpool more than £3m in 1986 for Mr Ian Rush, a Welshman.

In trying to satisfy those who would stop footballers from selling their skills where they wish in a frontier-free Europe, UEFA, the governing body of European soccer, has decided that no club entering a Europe-wide competition will be allowed to field more than four foreign players. This will probably be found to be illegal under European law; meanwhile, good sport may be had listening to British complaints.

For UEFA has, logically enough, decided that as the four component parts of the United Kingdom each field a separate national side, a Scot must be a foreigner in England, and a Welshman in Northern Ireland. English clubs have traditionally poached players from all over the realm. They will now have to find players English born and bred, which will be tricky. Two years ago Liverpool's team had only one player qualified to play for England, and he was really an Australian. Its current league-winners have only three or four.

Liverpool epitomises how daft protectionism is when applied to sport. The club employs sundry Scots, a Zimbabwean goalkeeper, a Dane with a Merseyside ac-

cent, a Glaswegian who represents the Republic of Ireland, and a Jamaican who plays for England. These players have united this year to give pleasure to millions, yet when Liverpool plays in Europe again (at the moment it is banned, its fans having caused the Heysel stadium killings in 1985) only four of these players will be able to entertain the public.

Moreover, the new UEFA rule would immediately kybosh the development of a global market in this most global of sports. This season has seen American soccer players at English clubs, while French clubs are signing new players from Africa. Luton won England's Littlewoods Cup last month when a Cape coloured scored two goals. It would surely be better for UEFA to drop its new rule before the courts force it to.



Spot the Englishman

BARINGS

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100,000,000 Shares of HK\$0.25 each
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Introduction
to
The Stock Exchange of Hong Kong Limited

Underwritten, placed and arranged by
BARING BROTHERS ASIA LIMITED
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October, 1987

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at
HK\$19.05 per Share

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TELECOMMUNICATIONS LIMITED**

in exchange for
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Cable and Wireless (Hong Kong) Limited

Financial advisers to
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BARING BROTHERS ASIA LIMITED

December, 1987

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ROAD HOLDINGS LIMITED

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INCHCAPE (HONG KONG) LIMITED
An Inchcape Pacific Company

Financial advisers to
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BARING BROTHERS ASIA LIMITED

January, 1988



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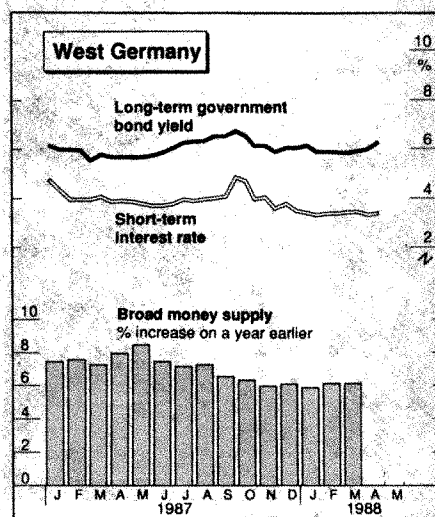
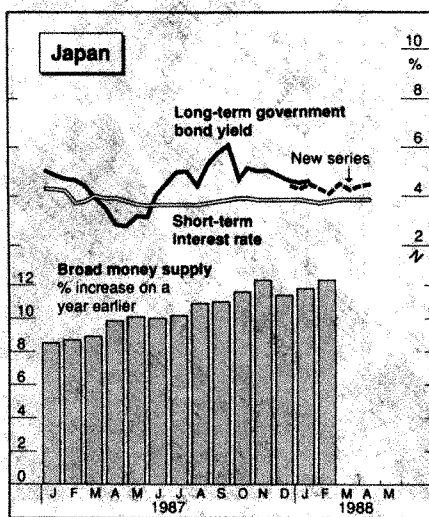
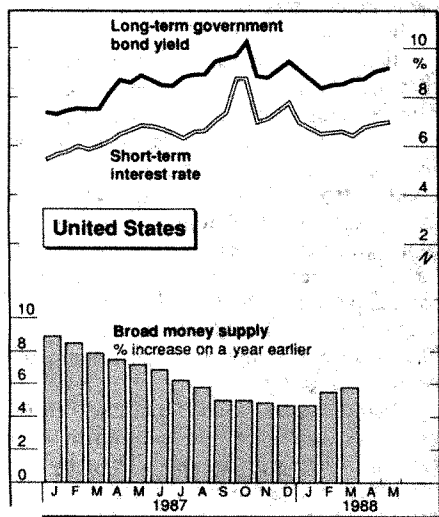
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FINANCE



Dearer money comes creeping back

BONN, NEW YORK AND TOKYO

FIRST the good news. Financial markets are getting used to the idea that last October's stockmarket crashes did not point inescapably towards a world recession. Now the catch. Since Black Monday the monetary authorities of America, Japan and West Germany have made it their top priority to keep interest rates down—to buoy demand, keep their economies moving and, above all, escape the blame for any slump that might be coming. In doing so they have met little or no resistance in their domestic bond markets. Post-crash, the thoughts of higher interest rates were far from traders' minds. As fears of slump recede, both sides of this equation are shifting. Central banks and financial markets now seem ready for dearer money.

Continuing signs of economic strength in America—where the crash was expected to hit demand hardest—have brought the bond market's inflation vigilantes galloping into view. Following a steady series of cheerful statistics, Treasury-bond yields have already touched nearly 9.1%, compared with the 8.3% to which they tumbled after the crash. Most recently the market has been impressed by unemployment claims (down in April), car sales (up) and consumer borrowing (also up). In the first quarter of 1988 GNP grew by 2.3% at an annual rate; some analysts are daring to predict 4% for the second quarter. With industrial capacity already at close to full stretch, this is the stuff of which inflation is made.

However, the bond market is probably less interested in the outlook for inflation, as such, than in the Federal Reserve's likely response to it. Mr Alan Greenspan, the Fed's chairman, is reckoned to be sound on inflation, even in an election year. Viewed in that light, America's domestic indicators are warning of higher interest rates.

The currency markets seem to point the same way. February's trade figures showed an unexpectedly large monthly deficit of \$13.8 billion. They may prove to be anomalous (yet again), but for the moment the currency markets have become more pessimistic about the dollar. With the risk of recession less pressing, interest rates can be used more readily to prop the dollar. So bad news on trade and good news on the domestic economy—which go hand in hand, linked by domestic demand—both suggest higher American interest rates.

Most pundits on Wall Street expect bond yields to climb at least to 9¼% and probably to 9½% before the May 10th Treasury financing, when the Treasury wants to shift some \$26¼ billion-worth of its debt. The view is that if the Japanese are to buy much of it, a generous yield will be needed—some fear as high as 10%.

Another school of thought, not to be lightly dismissed, still regards the economy as fragile. On this view, the risk that higher interest rates will kill the recovery is still greater than the danger of inflation. Even at present levels bond yields are beginning to look extremely competitive against a

stockmarket yielding only 3½%. And surely inflation worries are premature, since prices are still rising at only 3% a year? What a pity if false signs of recovery and exaggerated fears of inflation sent bond yields back up above 10%—at which point, note, the gap between bond and equity yields would be uncomfortably close to the seven percentage points that helped cause the crash.

All this is a horrible dilemma for Mr Greenspan. Even if the economy has shrugged off the crash, its domestic debt-burden has left it in a poor state to withstand higher interest rates. And Texas, in particular, is ready to stage a multi-billion dollar banking crisis. Nonetheless, all the signs are that Mr Greenspan has recently ordered a tighter monetary stance.

Partners in co-operation

Higher interest rates in America will succeed in propping the dollar only if Japan and West Germany keep theirs more or less steady. That would let interest-rate differentials widen in favour of the dollar, and stimulate demand for the currency. Alas, the Bank of Japan and the Bundesbank both have their own monetary policies to conduct. Like the Fed, they are shifting—or seem set to shift—towards tighter money.

Since the crash the Bank of Japan's main aim has been to hold the yen steady against the dollar. To that end it has held down interest rates, even when the money markets tried to push them up in response to seasonal shortages of funds. In the past few weeks, however, Mr Satoshi Sumita, the Bank's governor, has been letting the market have its way on short-term rates. Some in Tokyo are asking whether his new intention is for this to push long-term rates higher too, in order to cap inflation.

The Bank's spring Quarterly Economic Outlook hints darkly that "the present



Greenspan tightens ...

growth rate of money is quite high from the viewpoint of securing price stability in the long run" and that "some risks exist that the pressure for price increases could mount because of real and monetary factors". Consumer prices rose by only 0.7% in the year to March, but they are sure to rise at least a bit faster in 1988. The three-year decline in wholesale prices seems to have come to an end; the government wants to introduce a value-added tax as part of its tax reforms; and the rise in land prices of the past 18 months will feed through to the national inflation figures.

Underlining the Bank's concerns is strong growth in Japan's money supply. The broad measure—M2 plus certificates of deposit—expanded by 12.1% (compared to



... Sumita thinks about it

the first quarter of 1987) in the first quarter, the fastest rise since the second quarter of 1979. The Bank stressed that this was due to a shuffling of funds among types of bank and an increase in the build-up of idle cash balances by companies—but that probably does little to make it less of an inflationary threat in the Bank's eyes. The reins on commercial-bank lending have already been informally jerked. At a time when both output and the demand for loans to finance investment are rising fast, that is bound to put upward pressure on long-term rates.

Regardless of these signals, and whatever its true concerns, the Bank insists that its policy has not changed: "The Bank of Japan intends to maintain its present monetary stance", says the new report. Nice to

have that cleared up. Even so, American officials are entitled to be quietly horrified at the thought that they may be seeing their own interest rates rise—but to no avail as far as the dollar is concerned.

If they look instead to West Germany they will find, well, the same thing. The Bundesbank, which yields nothing to the Bank of Japan in its fear of inflation, has seen its targets for monetary growth shattered over the past two years. Lately this overshooting has been tolerated in the cause of low interest rates and a floor for the dollar. Now, with economic growth stronger than expected in the first quarter, together with upward revisions to the forecasts of the "five institutes", monetary officials are becoming nervous.

Many traders believe that the central bank has no choice but to bring its own rates into line with those dictated by the market as soon as possible—which means as soon as American rates have made room for it to be done without precipitating an immediate dollar collapse and another furious row with Washington. The German banks' current crop of advertisements may be offering good advice: borrow now, it will be a while before lending rates are this low again.

London property

How the West End was won

A QUICK guide to London's office rents used to be fairly easy to draw: it was like a target, with the Bank of England as its bull's-eye with the highest prices. No longer.

No taxation without representation

TOKYO

THE noisiest squabble at the annual meeting of the Asian Development Bank in Manila at the end of April was that between China and Taiwan. The most significant was that between Japan and the United States.

The mainland Chinese, members only since 1986, reached their peak of pique when the Taiwanese delegates covered up their lapel badges—which now say merely "Taipei, China"—with blue-and-white Republic of China flags. To rub salt into the wound, while China asked the Bank for a \$400m loan, Taiwan announced it was setting up a \$1 billion fund for overseas aid. Next year's meeting is due to be held in Beijing, which may bring even more political fireworks.

The deeper rift in the Bank, however,

is between its two most important members, Japan and the United States. Each of them wants to lead it. Japan supplies a third of the Bank's money; the Bank's president (Mr Masao Fujioka) and much of its management. But it still has only the same voting power as America (12½%), which makes the Japanese cross.

In 1986, when the Bank's capital structure was altered to take in China and five European members, Japan tried to get a bigger share of the votes, but was blocked by the United States. This year the Americans vetoed a Japanese attempt to increase its voting share to 16.4%. Japan offered to raise its capital subscription to the Bank, saying that the Bank needed more capital urgently.

The American governor, Mr Peter

Macpherson, voted against this. He said the Bank's capital should stay unchanged until an independent review of how the Bank should operate in the 1990s has been completed and "fully digested". This report is being compiled under the chairmanship of Mr Saburo Okita, a former Japanese foreign minister. It is due sometime next year. The Americans may then demand another year for digestion.

Mr Macpherson played down the role of the Bank, saying it was not the predominant lender in Asia, where the World Bank and bilateral donors play crucial parts. This annoyed the Asians. But there is a wider point. If Japan is to obey American calls to take on more of the responsibilities that its economic strength demands, then this new role has to be at the expense of the United States' own influence. It is the Americans at the ADB that are getting their politics and economics muddled.

Cheating is wrong . . . isn't it?

Few investors need convincing that insider dealing is a bad thing and that rules to prevent it make sense. Some economists are not so sure

WHEN the authorities in Britain or America nab a Geoffrey Collier or an Ivan Boesky and charge him with making money by exploiting inside information, the loudest debate is over whether such villains should be sent to prison, or just fined and disgraced. Economists generally keep quiet during such arguments. Granted, insider dealing is morally unpleasant. It often involves breaches of fiduciary duty; when that is so, it can be punished as such without qualms. Beyond that, however, there are two difficulties. The obvious one is that it is often hard to define who an "insider"—or his "victim"—might be. And then there is the horrible suspicion that insider dealing might actually serve a useful purpose.

The matter has been argued through in a new study by Professor Mervyn King and Ms Ailsa Roell of the London School of Economics, with a rejoinder by Professor John Kay of the London Business School*. The view that emerges is that although the moral case against the Boeskys and the Colliers can be stood up, bashing them may do nothing to help stockmarkets work better.

Stockmarkets, like all markets, are machines for processing information. The faster information reaches them, the sooner prices can take account of it, and the better they work. When an insider knows something the stockmarket doesn't, and acts on the strength of that knowledge, he moves share prices closer to where they will be when the news eventually gets out. As prices move closer to where they should be, decisions on the allocation of capital become more efficient. On this view, insider dealing acts as an economic lubricant.

If the market as a whole gains in this respect, who suffers? Is it the person who sold the shares to the insider? Not necessarily. He would have sold his shares anyway; if anything, he will have gained from the spur to prices that the insider's demand for the shares causes, albeit not by as much as if he had had the inside information himself. A more plausible loser is the person who would have bought the shares if the insider had not nudged prices fractionally up by entering the market. The trouble with this victim is that he is entirely hypothetical.

In the light of all this, the case against insider trading is often made to rest on the supposedly self-evident need for "confidence" in markets: they cannot work well

MARKET FOCUS

amid fears of frantic insider activity. This is not terribly convincing. Tokyo's stockmarket seems to work well—and to command more confidence among investors than most—despite (or because of!) plenty of what London and Wall Street would surely call insider trading.

Rather than pursuing this, Mr King and Ms Roell point to a different group of victims, and at the same time shed a helpful light on the question of market efficiency. The immediate counterparty to an insider's transaction is generally a market-



maker. If the insider had not come along, the market-maker would probably have held on to the shares concerned long enough to benefit from the price rise to come. In that sense he is a victim. In theory, however, market-makers should recognise that they will sometimes tangle with insiders better informed than themselves. They will protect themselves against resulting losses by widening the spread between their bid and offer prices. Fatter spreads in the aftermath of last October's crash show that this form of compensation against risk happens in practice as well as in theory.

As a result, if the amount of insider trading expands, so will the average bid-offer spread. The market as a whole then suffers by having to pay more to conduct its business. This implicit tax on financial transactions not only has victims, it is inefficient. Plenty of evidence suggests that the volume of trading on stockmarkets is sensitive to the cost of transactions. So any insider-dealing "tax" is likely to be highly distortive.

At this point, most right-thinking prejudices on the subject could happily rest. Mr Kay, however, is still unhappy. He points out that regulators might adopt one of three approaches to insider trading.

First, they could try to enforce equal access to information. This, in principle, is the position of the British authorities. But it is a bit of a sham. The rules apply to true insiders (ie, those "connected" with the relevant company), but not to what Mr Kay calls "quasi-insiders" (eg, securities analysts, market-makers and journalists). Quasi-insiders are allowed (by law, though not always by their employers) to act on unpublished information. It could hardly be otherwise. Without such a dispensation the business of securities analysis would have to shut down. To insist on a truly level playing field for every buyer and seller is, in the limit, absurd: the only plausible common level of knowledge is none at all.

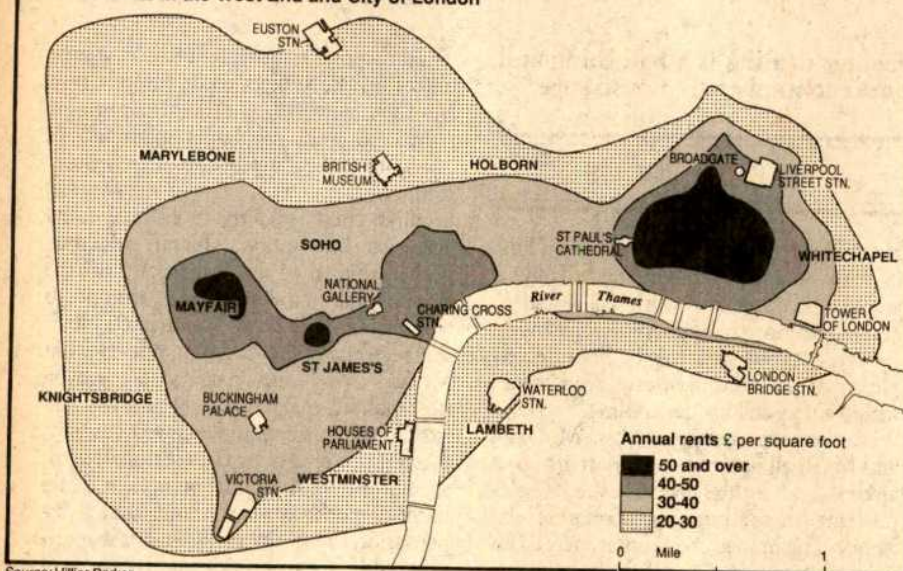
A second course is to let insider trading flourish. Then the drawback stressed by Mr King and Ms Roell would come to the fore. Bid-offer spreads would widen, and the volume of trade would shrink, perhaps by a lot. The third option is the present approach—as it works in practice, rather than as it is advertised by the authorities. This tries to prevent deals by insiders but not by quasi-insiders. It therefore promotes a great deal of financial-market trading, and lets the securities analysts go about their profitable work.

The open question is whether this is really more efficient than a relaxed attitude to insider trading. The current approach fits the idea that stockmarkets are casinos, to which governments should ensure access for all, and at the fairest feasible odds. But, as Mr Kay says, "the stockmarket is not primarily a gambling venue . . . the efficiency of the capital market is the principal concern." In Britain it is a commonplace that closer relations between firms and their financiers would enable capital to be allocated more efficiently. For this to happen, the ideal of equal information will have to make further compromises. The result could be more insider trading and a higher implicit tax on transactions—outweighed, perhaps, by the gain from a better use of capital. Ridiculous thought: might popular revulsion at insider trading then fade too?

*"Insider Trading". By Mervyn King and Ailsa Roell. *Economic Policy* No 6, April 1988.

Westward high

Office rents in the West End and City of London



As the map shows, rents in the West End are now broadly in line with the City's.

According to Hillier Parker, a chartered surveyor, prime West-End rents at around £55 (\$102) a square foot are still about £7.50 behind prime spots in the City. That gap is closing. A small West-End site in St James's, near *The Economist's* offices, has reputedly reached £70. A better benchmark for the West End is Lansdowne House in Berkeley Square, which has 176,000 square feet to let: it is trying to get rents of over £60 a square foot.

Some property buffs are betting that eventually the West End (particularly Mayfair and St James's) will follow the example of midtown Manhattan and streak ahead of the "downtown" City. One reason is comfort: the West End has better shops, theatres, parks and easier access to Heathrow and Gatwick airports. And now that shares are traded by telephone instead of face to face, investment banks have felt able to settle in the west, including Salomon Brothers in Victoria, Morgan Stanley in Wigmore Street and several others.

The other reason is supply. There are only around 6m square feet of offices under development in this large area, and little of that is in Mayfair or St James's. And unless Westminster Council changes its mind, around 1m square feet of temporary office space will revert to domestic accommodation in 1990.

"So what?" argue City office-builders. Most financial institutions want to remain within easy access of each other. It is not because City rents are falling that they are being caught up: last year they rose by "just" 47%, while the West End's jumped by 67%. Around £2 billion was ploughed into the development of land and buildings in the square mile. Morgan Grenfell Laurie, a

property-finance house, estimates that the current pent-up demand for around 5m square feet of office space in the City will not be satisfied until late in 1989. The rents on several small leases have topped £70.

A good indicator for City rents is Broadgate, a 4m-square-foot development. Even though it is on the fringe of the square mile (by Liverpool Street station) it has the big, modern arenas needed for trading floors (which most West End offices do not). After the October stockmarket crash two prospective tenants—James Capel and Paine Webber—dropped out. But now Broadgate is selling well. One of its original tenants, Shearson Lehman Hutton, which pays rent below £30 a square foot, has sublet space to County NatWest at over £50.

Yet the City is changing. Many financial firms that had assumed their workforces would grow by, say, 8% a year, have had to sack employees since October. Some of this slack has been taken up by others: in 1986 80% of enquiries for space in Broadgate came from financial institutions; now 70% are coming from accountants or solicitors which, newly merged into bigger firms, want one large headquarters rather than being spread between several small buildings.

Life may be more difficult after 1989, as supply pulls ahead of demand. Morgan Grenfell Laurie guesses that the total increase in City floor-space over the next five years could range between 8.9m and 11.4m square feet whilst demand might be as low as 8m square feet. Morgan reckons that rents will rise to around £85 and then stay there. Less bullish observers say that rents will simply fall.

And there is also Canary Wharf, a 10m-square-foot development two and a half miles to the east of the City in Docklands. Its low rents of around £25 a square foot will



Former bull's-eye

be most attractive for financial back-offices or, perhaps, for industrial firms looking for a London headquarters. It is also trying to lure some of the City's top-ranking front-office tenants when it first becomes available in 1990. Canary Wharf already has two investment banks now in the West End, Morgan Stanley and Credit Suisse First Boston, pencilled in as tenants. Mind you, many of CSFB's and Morgan Stanley's high-living staff say they will take the train to Docklands only if the rent saved is passed straight into their pay packets.

Texas banks

Over the brink

BANKS in Texas are disappearing as fast as flowers in a heatwave. Of the American banks to have failed this year, 21 have been based in the Lone Star state; last year Texas accounted for 50 of the 184 bank failures in America. Only one large Texan bank, Cullen/Frost Bankers, managed to get through the first quarter of 1988 without making a loss; at the other end of the scale Texas's biggest bank, First Republic, made the second-biggest quarterly loss in American banking history—only Citicorp's \$3 billion provisioning against its third-world debts last year caused more red ink.

This crisis will weaken the Federal Deposit Insurance Corporation (FDIC) which has only around \$18 billion in its deposit-insurance fund. A New York brokerage house, C.J. Lawrence, reckons that the American government has already spent \$6 billion shoring up the sickest Texan banks. Unless the Texan economy—and, crucially for banks, the state's property market—re-

covers, far more than that \$6 billion will be needed to recapitalise bust Texan banks. Drexel Burnham Lambert, the investment bank that pioneered junk bonds, has already noticed that helping the FDIC out in Texas could restore its reputation as well as proving profitable. Earlier this year it replaced Morgan Stanley as First Republic's investment bank.

Last month it stepped in to salvage the fraught rescue of First City Bancorporation. A rival investment bank, Donaldson Lufkin & Jenrette (DLJ), found that it had underwritten \$100m more in preferred and common stock than it was able to find buyers for. So DLJ called in Drexel Burnham and its controversial junk-bond king, Mr Michael Milken. Drexel increased the interest rates on the preferred stock and then pushed the paper out to its usual junk-bond investors.

Drexel's intervention saved the First City deal. Earlier, Drexel had been more of a saboteur. The investment bank was among those arbitrageurs that bought high-interest City bonds but refused to exchange them for the cash that Mr Robert Abboud, the former chairman of First National Bank of Chicago, was offering.

Aware that the bonds were secured against the solvent banks in the group—exactly the assets that Mr Abboud was after—and that holders would have first claim in the event of liquidation, the arbs held out for better terms, which they got. Instead of getting rid of 90% of the bank's \$226m debt, Mr Abboud got rid of only 68%. That means debt interest will be higher for the recapitalised bank than Mr Abboud originally forecast. The FDIC suffered because it had to assume all the contingent liabilities of one of the larger banks in the First City group.

Originally, the FDIC intended to put only \$970m into the deal. The rest of the recapitalisation depended on three other sources: the \$500m equity issue organised

Donaldson Lufkin & Jenrette; the spinning-off of bad loans into a separate "junk" bank; and Mr Abboud's separate "junk" bank's costs. A full-blown rescue of First City of the sort used for Continental Illinois four years ago, might have cost the FDIC, initially at least, more than \$2 billion. In 1984, when Continental Illinois was nationalised, the regulators spent around \$7 billion to stabilise the bank. But the net cost has now shrunk to around \$2 billion.

It will probably cost more, ultimately, to save First Republic. The bank's first-quarter loss of \$1.5 billion leaves it with negative equity of \$334m. Restoring its equity to around 4% of its \$28 billion in assets would cost about \$1.4 billion. During the first quarter, First Republic took a loss on around 7.5% of its non-performing assets. Suppose that eventually about a quarter of the bank's \$4.5 billion in dud loans is charged off. That will cost \$1.1 billion—

more if the bank's loan portfolio goes on deteriorating at the present rate. Also, the bank has a \$1 billion deposit from the Federal Reserve Board.

The size of First Republic and the doubtful nature of a huge chunk of its assets—already the bank has recognised that 19% of its assets are non-performing—makes an Abboud-style recapitalisation unlikely. The bank seems to be reconciling itself to life in the shadows of nationalisation. Already the regulators have changed the bank's top management and replaced Mr

"Bum" Bright, the director who promoted the disastrous merger between Republic and InterFirst in 1986 (and principal owner of the Dallas Cowboys football team).

MCorp, now Texas's largest independent bank, has loan-loss reserves equivalent to only 25% of its \$1.6 billion in non-performing assets. But unlike First Republic, MCorp has taken a harsh view on its assets for over a year. This conservative attitude perversely makes MCorp the most attractive bank stock for a gamble on an economic recovery in Texas.

J.P. MORGAN

The Morgan Bank tries a cultural revolution

NEW YORK AND LONDON

One of the world's best-known wholesale banks, J.P. Morgan, is transforming itself into an investment bank, specialising in corporate advice and securities trading. Many other commercial banks want to follow it. They should be warned that the change has proved tougher than Morgan expected. Declining volumes of business and painful trading losses have made Morgan shy away from some markets, most notably international equities

BY NOW, J.P. Morgan has moved too far towards investment banking to turn back. When it realised that its blue-chip corporate clients needed fewer bank loans, Morgan had to make a choice: either stick to commercial banking and chase middle-market companies that still want loans; or stay with its traditional clients and become their investment banker. It chose the second and more aristocratic course. John Pierpont Morgan, who at the turn of the century built his father's bank into the world's most pow-

erful, would have approved. In 1912 he told Congress that he "would not lend money to a man he didn't trust".

Borrowers (apart from governments) may not be becoming less trustworthy, but lending is playing a declining role in the balance sheet and profit-and-loss-account of J.P. Morgan. (Morgan calls its commercial bank Morgan Guaranty Trust.) The bank's portfolio of loans to commercial and industrial firms shrank from \$15.7 billion at the end of 1986 to \$12.7 billion at the end of 1987. For several years, J.P. Morgan's "non-interest operating income"—earnings from trading currencies and securities, from securities investments, from advice and from managing money—has been catching its interest income. In the first quarter of 1988 non-interest income was only \$3m behind net interest income of \$438m.

In February 1986 Morgan introduced a new organisational structure to reflect the declining importance of its loan book. The corporate-finance group, under Mr Sandy Warner, now covers both lending and advice. Mr Warner says that the bank will still lend to investment-grade borrowers, but that "just lending to BBB-and-above-rated clients is a bankrupt business. There are other banks prepared to lend for a lower margin than Morgan would demand."

So Morgan bankers who once made loans will now advise on, say, a yen commercial-paper issue swapped into dollars, or on making an equity investment in Brazil. Many of its bankers have been retrained. In



Pierpont was no middle-marketeer



The old House of Morgan...

the London office since 1983 the number of "bankers" has dropped from 90 to fewer than 30, while the number working in specialities such as taxation and Eurocommercial paper has grown.

Because of the regulatory straitjacket of America's Glass-Steagall act, which keeps banks out of some underwriting and trading businesses, the thrust of Morgan's expansion into securities has been in Europe, and particularly in London. Since the early 1980s Morgan has established itself as a top underwriter of Eurobonds. More recently the bank has built up its trading and sales of international bonds, and has grown to dominate the market for currency swaps.

Muscling into these businesses has been a bruising experience. Two years ago Morgan was delighted to have become a top market-maker of perpetual floating-rate notes (FRNs). When prices in that market collapsed in late 1986 and early 1987, as investors noticed that such notes are not really liquid, Morgan was left with large and unsellable positions. The bank had to register losses on these FRNs of about \$50m in 1987.

In the swaps market Morgan's computers failed to keep pace with the growth of its business. From spring 1986 until autumn 1987 Morgan struggled with bugs in the software of a new swap-accounting system in London. This failed to provide information on the bank's exposure—its swap positions and hedges—to currency movements. Exposures had to be worked out manually; that was worrying, given the complexity of the maths involved. For a while Morgan had to slow the growth of its swaps book, which is now worth \$80 billion-90 billion.

Morgan's head office in New York then became worried about soaring costs and poor profitability in its 1,500-man London operation. In the wake of October's stockmarket crash J.P. Morgan abandoned

plans to build up its international-equity group in London from scratch to more than 40 people. Morgan also pulled back from talks about buying Wood Mackenzie, a stockbroker being sold by Hill Samuel.

This strategic shift miffed some in London, such as Mr David Band, the Scottish chief executive. He and others thought London should have more say. Mr John Olds, the tough new head of securities in New York, who had responsibility for London, disagreed. Mr Band also resented being blamed for the problems in perpetuums and swaps. So in March he left to become chief executive of Barclays de Zoete Wedd.

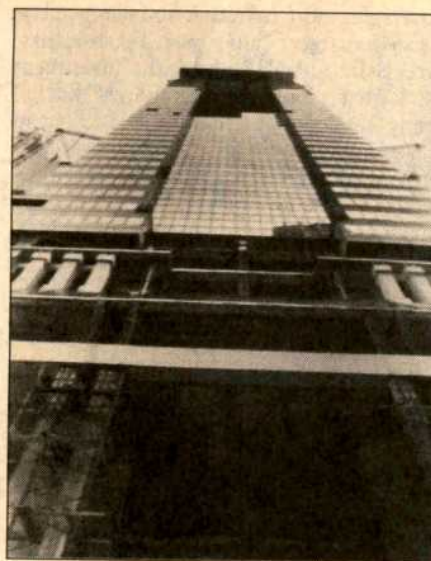
Morgan has now pruned several areas of its securities business. It has pulled out of some Eurocommercial paper programmes on which it acted as dealer, and has abandoned the trading of non-sovereign FRNs. Morgan's redeployment of capital and people away from several capital markets has dented morale among its securities staff—now totalling 2,500 worldwide. Poor bonuses at the end of last year did not help. In areas such as swaps and Treasury options (a new unit in New York which has lost money) there has been a string of departures. Some quitters rate Morgan as shortsighted for cutting back while the markets are sticky. Next time the markets flourish, it may be hard to jump back in and capture a leader's share.

Some of those leaving Morgan question the bank's long-term commitment to securities. Mr Olds agrees that the tactics have changed, but says the long-term goals have not:

Virtually everyone became over-extended in the bull market, and we were no exception. In my judgment the global equity market is going to develop more slowly than many people think. London can no longer be considered as the sole centre of the international securities business, and so it should not be regarded as the only measure of our expansion. We are active in places like Tokyo, Zurich, Paris, Frankfurt, Hongkong and Australia, and we want all our securities operations to get in sync. So we are shifting some experienced people to new places and others into new disciplines.

Can pay, won't pay

The old corporate culture of the House of Morgan stressed teamwork, and discouraged individual stars. It emphasised the long-term interests of clients, rather than the short-term gains that might come from a particular deal. It made the bank a "nicer" place to work than many other financial firms. Morgan's move from commercial towards investment banking now means that its executives must work with shorter time-horizons, and that there is now a premium placed on individual creativity. Some Morgan values still hold, but the bank cannot remain a gentleman's club if it is to compete against rival investment banks. Life is becoming tougher. Second-raters are being



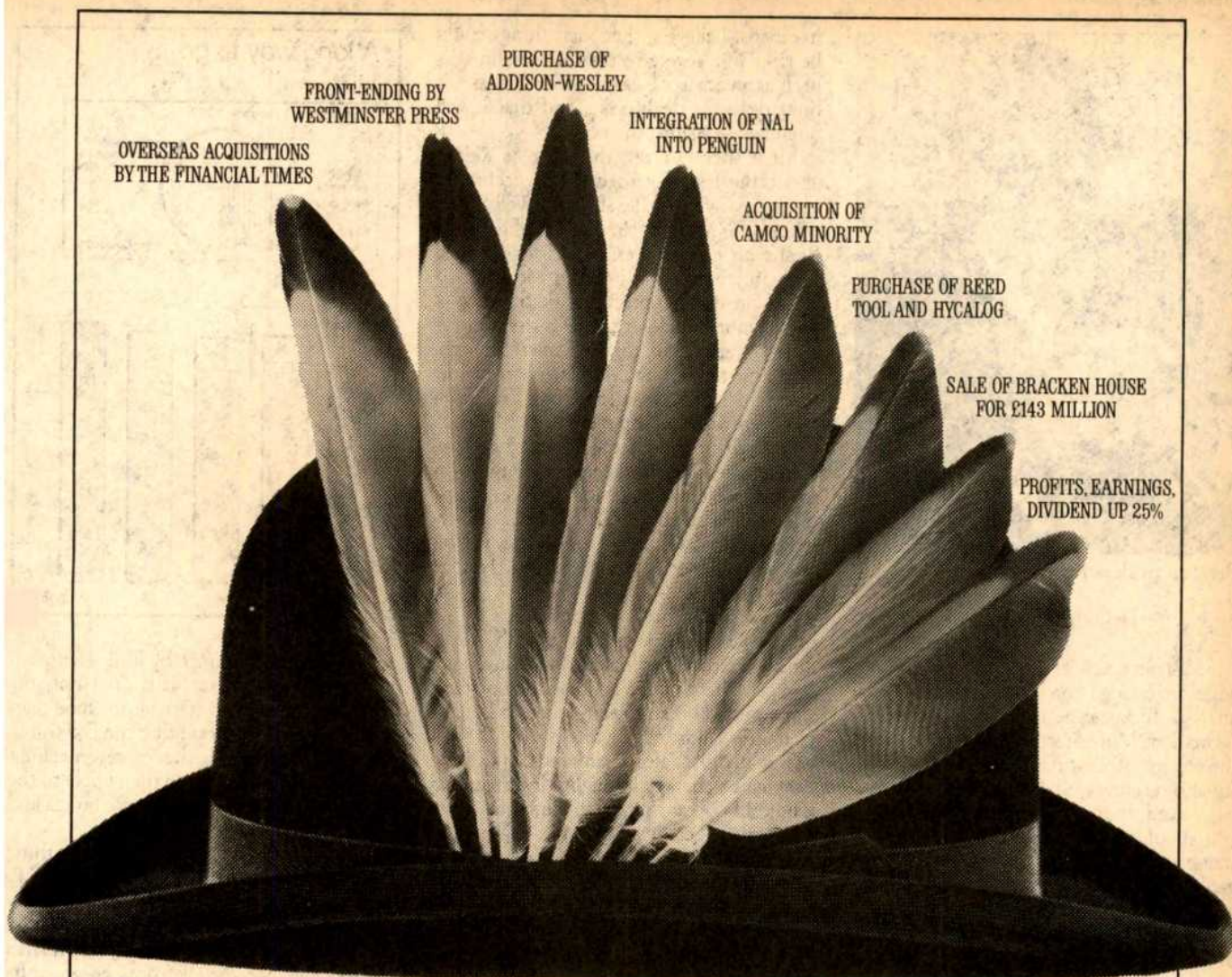
... and the new

given their cards. Mr Robert Gray, an Englishman who runs Morgan's Tokyo securities affiliate, says the bank has become less leisurely because of the shorter timespan in which people are forced to act. "It is more frenetic and demanding than it was, but we still communicate across the bank better than other firms."

The pace of change has affected Morgan's internal politics, although not as rudely as in some other investment banks. Staff fretted during a long struggle between the treasury and the securities division over the frontiers between them. The treasury is supposed to be responsible for trading in short-term securities, while the securities division looks after the long term. Last autumn Mr Dennis Weatherstone, the bank's president and an English foreign-exchange trader by origin, settled the dispute: Mr Kurt Viermetz, the treasurer, took control of securities operations in continental Europe and of swaps—while Mr Olds was given responsibility for London and Tokyo.

The shift to investment banking has weakened another Morgan tradition, that of giving all staff similar and relatively low pay. The bank used to avoid paying specialists more than other staff, since it liked to move people around. Mr Lewis Preston, the chairman, says that has changed. He claims that pay at Morgan is now up with that at the top investment banks. "This change has been hard for a bank which belittles profit centres except as a management tool. You need to get the best people—yet that endangers our 'one bank' philosophy."

What happens when a specialist moves to work in a less highly-paid part of the bank? Mr Preston says that Morgan will no longer insist that he or she must move around. Any executive who does move will retain the same base salary. The bank still awards bonuses on a qualitative basis, to encourage teamwork, rather than linking them



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Preston prefers teamwork

directly to an individual's contribution to profits.

Morgan's new approach to pay has not gone far enough for some bright financial analysts. In some specialist areas of the capital markets Morgan still pays much less than the top investment banks. Said one specialist who recently quit: "Morgan is such a secure, comfortable environment that I accept you should get 20% less than Wall Street wages. But 50-60% less is too little." Morgan's reply is that those specialists who do well do earn plenty. Some high-fliers took home even more than Mr Preston's \$1.3m in 1987.

Even in mergers and acquisitions, an area in which J.P. Morgan wants to grow, the bank has not resorted to fancy salaries to attract outsiders. Mr Roberto Mendoza—a British-educated Cuban who, having piloted the bank's expansion in the Euromarkets, is now trying to do the same in the takeover business—says that his division has hired only two professionals from other firms. J.P. Morgan sticks by its tradition of rarely buying outside people or firms. It would take too much time to "Morganise" them, says Mr Preston. If people leave the bank, says Mr Mendoza, it is usually for a reason other than money.

Shaking the Street

Some of its rivals feared that Morgan might use its capital base and lending power to boost its market share in takeover business. That is what investment banks such as First Boston are trying to do with their "merchant banking". Morgan does not. If it financed takeovers as well as advising on them, it fears it could face conflicts of interest. The Glass-Steagall act does not preclude the bank from taking equity stakes in takeover targets, but Morgan prefers not to. It lends little for leveraged buy-outs and bridg-

ing loans, believing that such things could be risky in a severe recession. Morgan sells itself as an adviser by saying that it does not hunt deals for deals' sake, and that it will often advise against them.

It is therefore not throwing its weight about, but is deploying its power to undercut prices. What really shocked Wall Street when J.P. Morgan advised Hoffmann-La Roche on its unsuccessful bid for Sterling Drug in January, was not that Morgan had rattled on its relationship with Sterling; it had been much closer to the Swiss firm for much longer than to the American one. What hurt was that Morgan charged low fees: \$1m for advice and a further \$7m if the takeover had been completed. Mr Mendoza believes that the investment banks have created an oligopolistic system for charging on takeovers. He says that Morgan's fees will be more closely related to the value of the service provided, which means that they will often, though not always, be lower than its competitors'.

In consequence, Morgan's share of the takeover business is growing rapidly. Deals during the past year included advising Paine Webber when Yasuda Mutual Life bought a stake in it; BHP Petroleum when it bought Hamilton Oil from Volvo; SAS when it tried to buy British Caledonian; and SmithKline Beckman when it bought International Clinical Laboratories. In the first quarter of 1988 takeover advice played a big part in sending income from fees and commissions surging to \$196m—a 91% improvement on the same quarter of 1987.

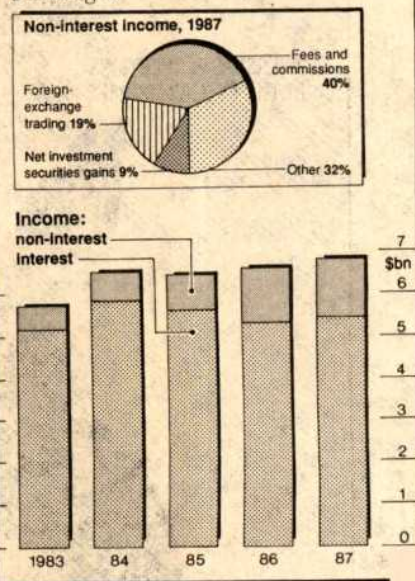
The Glass-Steagall act has not prevented J.P. Morgan—and other commercial banks—from taking on the investment banks in several American capital markets. The bank can and does deal in Treasury bonds, some sorts of municipal revenue bonds, as well as those mortgage-backed securities that are government-guaranteed. And in equity markets America's courts have granted commercial banks the right to provide a research and brokerage service. So J.P. Morgan Equities Inc is recruiting on Wall Street, and has applied to join the New York Stock Exchange.

Even if the Glass-Steagall act staggers on for a few more years, the courts may soon offer banks some further solace. Section 20 of Glass-Steagall says that no bank affiliate can be "principally engaged" in the securities business—except in those markets, such as government bonds, which are specifically permitted. Last year the Federal Reserve interpreted this as meaning that banks could underwrite and deal in commercial paper, all municipal bonds and all asset-backed bonds, so long as the resultant revenues did not exceed 5% of a securities subsidiary's total revenues.

The Securities Industry Association challenged this ruling in the courts, and has now appealed to the Supreme Court, which

A long way to go

J.P. Morgan



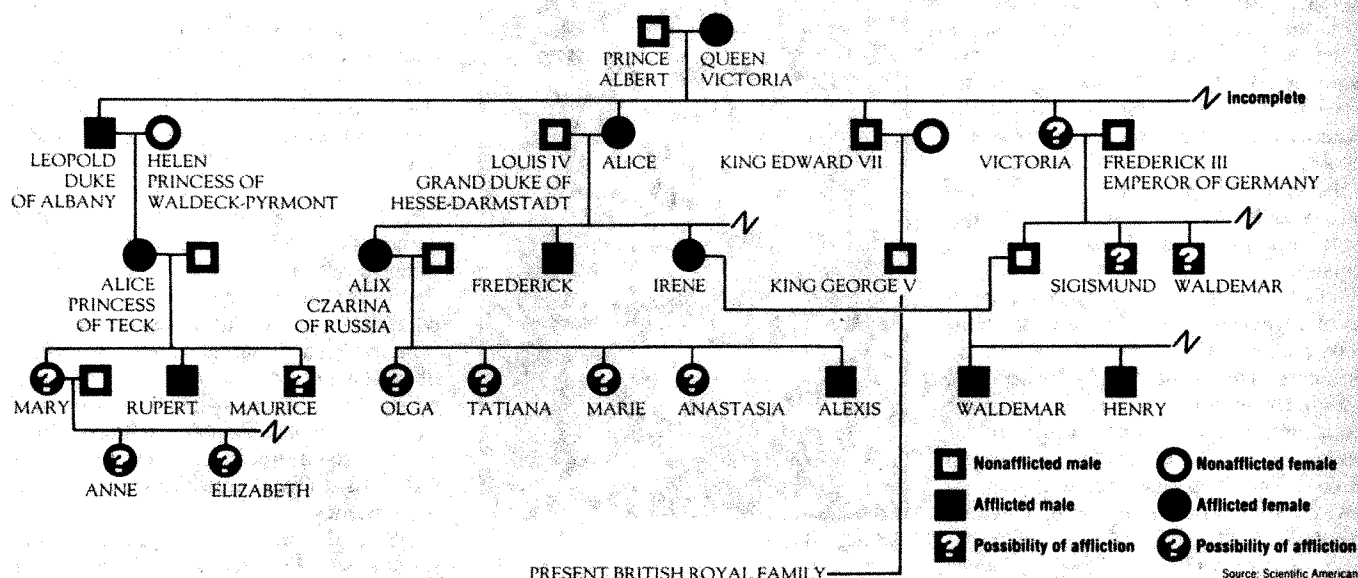
Source: Company reports

is expected to announce by June whether it will review the matter. If it does not, the banks will be free to start up in these markets, with the likelihood that the Fed will in subsequent years raise the 5% revenue limit to 10%. The banks would then apply to the Fed to be allowed into corporate bonds and equities under section 20.

Neither Glass-Steagall nor teething troubles in securities markets will deter J.P. Morgan from its long-term ambition of becoming an international investment bank. But Morgan will advance more gingerly than before, and not on all fronts at once. Its main competition will no longer come from America's other money-centre banks—except, perhaps, from Bankers Trust and Citicorp. It now has to compete with the short list of global investment banks.

One disadvantage for Morgan is that its huge size—15,000 staff, 5,000 of it abroad—makes it unwieldy and slowing. It has laboured long over organisational changes, and admits that it has moved into new markets such as Eurobonds and Eurocommercial paper later than it should have done. But size has its advantages. J.P. Morgan's \$5 billion of equity capital outguns most of its non-Japanese rivals. It can afford to take losses and march on. Morgan is also more international than America's leading investment banks: it has a broader foreign network and nearly all of its top managers have international experience. Three of the top six are non-American. It can claim to be better managed than many of Wall Street's most illustrious houses. Morgan has as good a chance as any in the international investment-banking super-league, which is why some of its teething troubles should be a warning to others.

SCIENCE AND TECHNOLOGY



Contesting man's inheritance

QUEEN VICTORIA had one bad gene and it went a long way. Fecundity, good marriages and the laws of heredity spread haemophilia—of which she was a carrier—throughout the royal families of Europe. Some 4,000 such diseases, caused by a defect in a single gene, have been identified. Many others (including diabetes, manic depression and alcoholism) are used in part by several faulty genes.

The ideal way to cure inherited disease would be to treat the genes themselves. That work is now almost ready to begin. Scientists at the National Institutes of Health in Bethesda, Maryland, reckon that by the end of the year they will be ready to apply for approval to administer genes to infants suffering from a rare and fatal genetic disorder of the immune system, known as SCID.

Why start with that? Consider first the problems of tampering with man's genes. One snag is how to put in new ones. From a scientific point of view, an attractive way would be to inject foreign genes into an embryo. The new genetic trait would then pass to the child and its offspring, and so on forever. But, as a new study of gene therapy illustrates, scientists have fought shy of this approach.* Anything that affects future generations would be too controversial.

A second way to put in new genes—

called somatic-cell gene therapy—affects only the people treated, not their descendants. But it is much harder to do. Cells are taken from patients, new genes are put in the cells, then the cells are returned. The snag is getting the new genes to the part of the body that needs them.

Most gene therapists have concentrated either on SCID or on beta-thalassemia. Both are single-gene disorders and so could be treated by the introduction of a solitary gene. Infants with SCID lack the gene that contains a coded recipe for the protein adenosine deaminase (ADA). Without this protein, substances that damage the cells of the immune system build up in the body. Beta-thalassemia is caused by a fault in the production of beta-globin, which helps to carry oxygen around the body. Since both diseases are blood disorders, they can be cured by endowing young bone-marrow cells, known as stem cells, with the right gene. Stem cells multiply in the body, giving rise to all the other blood-forming cells.

So stem cells are a good target for gene therapists. But how do you get the new genes in? The most promising way, devised by scientists at the Whitehead Institute in Cambridge, Massachusetts, relies on a type of virus called a retrovirus. The good thing about retroviruses is that they carry instruc-

tions which can stitch genes into human DNA (the material of which genes are made). The bad thing is that they can also multiply and activate "oncogenes" in the body. Oncogenes can cause cancer. So scientists have tried to build a synthetic viral particle, known as a viral vector, that can infect bone-marrow cells but cannot produce fresh retroviral particles. Building them takes three steps:

- Assemble a "construct". A construct is composed of the desired gene—eg, the ADA gene—and "promoters" to switch the gene on and get it working.
- Take a culture of mouse cells, and put all the retroviral genes except one, dubbed Psi, into their DNA. Psi is the genetic signal needed to complete the assembly of the retrovirus; without it the mouse cells cannot produce retrovirus.
- Put the construct into the engineered mouse cells. These cells then produce the viral vectors—which carry the ADA gene and the other instructions it needs to get into human DNA—but not whole retrovirus.

The viral vectors can then infect bone-marrow cells and the cells returned to the patient. Such vectors have been used to introduce both human ADA and beta-globin genes into mice. In both cases they worked: beta-globin proteins were synthesised in the red blood cells where they are normally found; and in one experiment the proteins were produced for half of the rest of the mouse's life. However, in both ADA and beta-globin treatments, the amounts of hu-

* "Human Gene Therapy" by Eve Nichols. (Harvard University Press, 1988). \$9.95

man protein produced were tiny. Scientists at Baylor College in Houston seem recently to have done better than others in this respect. But the amounts produced are still far too low for gene therapy to cure humans.

Dr French Anderson and his colleagues at the National Institutes of Health have also inserted ADA into monkeys. Their results have been disappointing, particularly because the effects did not last for long. It is possible that the ADA genes did not transfer to the stem cells but to some other bone-marrow cells. Nevertheless, Dr Anderson wants to perform clinical trials on SCID patients soon.

His critics point out that small quantities of retrovirus crept into the viral vector preparations in Dr Anderson's earliest experiments. The construct and other viral genes in the mouse cells managed to realign and form a complete set of instructions for making retrovirus. Dr Anderson's group thinks it can overcome this. It is keen to move on from monkeys and try ADA therapy on people because only people get SCID.

Experiments with people might produce much better results than monkey trials suggest. It could be that more ADA protein would be made in man: when ADA is produced in people, more and more cells of the immune system that would otherwise have been destroyed will survive. These cells in turn can produce more ADA.

Thus far scientists have trod carefully around gene therapy because its treatments are irreversible (whether they affect future generations or just one patient). Also, they make people worry about mutants. But the mutant was Queen Victoria—hence royal haemophilia. As gene therapy gets closer, its promise gets more enticing and caution seems more tiresome. No fewer than seven groups oversee it in America. Will safety-first deprive the dying of treatment?

Electricity in the third world

A dark future

DEVELOPING countries have three-quarters of the world's population and use just 18% of its electricity. Four-fifths of their inhabitants live in rural areas with no electricity, so consumption per person is low: around 500 kilowatt hours (kWh) each year, compared with 10,500 kWh in America. But as a country develops, its appetite for electricity gets keener. Since 1980 electricity consumption in poor countries has grown by an average of 7% a year (compared with less than 2% a year in rich countries)—largely because their industries tend to be energy-hungry processors and manufacturers, not less voracious service companies.

How are electricity suppliers in the third world to cope with this increasing demand?



A tangled tale

They are rather inefficient and their networks often break down. On average, power stations in developing countries use 40% more fuel than their American counterparts and are fit for operation only 35-50% of the time (compared with 70-85% of the time in industrialised countries).

This makes electricity expensive to produce, so governments subsidise it. An agricultural user in India pays just 20% of the marginal cost of generation for his supplies; in Egypt, he pays 40%. Add such subsidies to the cost of building new power stations, and governments are left with electricity bills they can ill afford. On average, electricity companies in poor countries eat up 20% of government development budgets and their borrowing can amount to some 40% of a country's foreign debt.

A dilemma looms. On the one hand, poor countries need to make power supplies more reliable and more widely available. In India, for example, lost industrial output caused by power shortages in the mid-1980s cut GDP by 1.5% each year. Yet the traditional response to shortages—building more power stations—may soon stall.

America's Agency for International Development (USAID) reckons that developing countries' electricity consumption will grow by 6.1% a year over the next 20 years—if the World Bank's "medium" forecasts of 4.5% a year real economic growth are borne out.* The agency believes that if developing countries are to meet that demand they will need to build 1,500 gigawatts of new generating capacity. That would mean an investment of \$125 billion each year, compared with the \$50-60 billion a

* "Power Shortages in Developing Countries" USAID, Washington, 1988.

year which poor countries are investing in electricity supply now.

Because these countries are straining to pay today's bills, doubling expenditure is out of the question. At present tariff levels, their electricity suppliers will generate only enough revenue from selling electricity to cover a fifth of their investment needs over the next 20 years. Loans from the World Bank and other development agencies will, at best, meet another 40%.

The agency has two pieces of advice. First, developing countries should gradually withdraw subsidies on electricity. Low customer tariffs encourage high consumption, so government-owned electricity companies concentrate on building large power stations, which are often unsuited to the needs of rural areas. Worse, low prices discourage private companies—which would build smaller, more flexible power stations—from entering the business. Involving the private sector, USAID reckons, is the key to improving efficiency.

Second, building new power stations should take a back seat to conservation. Pakistan's Water and Power Development Authority calculates that by spending \$170m on improving its power stations' fuel efficiency, it could cut generation costs by 12%. And fitting capacitors to power cables could help stem transmission losses, which in Pakistan—not an extreme example—add up to 27% of all electricity generated.

Cheap, low-technology conservation measures can reduce consumption. Electric motors, which gobble more than 40% of the electricity produced by poor countries, can be fitted with variable speed controls. These reduce consumption by 20-30%. Load management—electropeak for encouraging consumers to use "off-peak" power—reduces power cuts and the need for new generators. "Co-generation"—capturing and using the heat wasted by generation—has much the same effect.

At present every 1% increase in a poor country's GDP pushes up its electricity consumption by 1.4%. USAID argues that cost-related pricing, together with conservation and efficiency measures, could reduce this to 0.9% within 20 years. That would halve the number of new power stations needed over the period, leaving the developing countries with an annual investment bill little higher than it is today.

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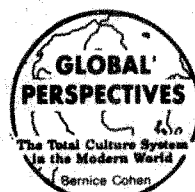
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some astronomers have claimed that a rallying of galaxies is happening on a hitherto unrecognised scale in our part of the universe. They believe that the Milky Way galaxy (with our sun in it), and most of its neighbours, are heading off towards something they call the Great Attractor, roughly 200m light-years away in the direction of the stars of the Southern Cross.

This herd instinct is normally thwarted. The universe is expanding, so its galaxies are moving apart like the currants in a rising currant bun. From wherever in the universe you look, the galaxies will always be moving away from you; and the farther away they are, the faster they will flee.

If galaxies were distributed evenly, that would be the whole story. But they are not. The mass in the universe is spread out unevenly, and so there are more galaxies in some regions than in others. The galaxy-rich parts attract yet more galaxies. The Milky Way has been pulled into a cluster of a dozen or so galaxies, called the local group. The local group, in its turn, is on the edges of the Virgo "supercluster".

How a galaxy moves can be worked out from the colour of the light that arrives from it. If it moves away, the light it sends out is stretched, so it arrives on earth with a longer wavelength than it set out with—ie, it is redder. Most galaxies farther away than the local group get this "red shift". By and large, it increases with distance.

If galaxies are trying to move together, then their red shifts will show it. A group of astronomers, known in the business as the seven samurai, thinks that they do. In one part of the sky, things in the near distance are moving away too fast; opposite that, they are receding too slowly. This suggests an overall drift towards the region where the red shifts were peculiarly high, which implies something bigger than a supercluster sitting out there beyond them and pulling. The idea is supported by other evidence that the Milky Way is moving in a similar (but not identical) direction.

The samurai were looking only at elliptical-shaped galaxies. Another group, now led by Dr Jeremy Mould at the California Institute of Technology in Pasadena, got similar results for spiral galaxies. That seemed to confirm the samurai's attractor, but there are complications. In the same direction as the putative attractor, but only about two-thirds as distant, is an extremely large supercluster (the Hydra-Centaurus supercluster). According to the samurai and their elliptical galaxies, it is moving towards the attractor. Others are not so sure.

Dr Mould thinks that there may be movements within the supercluster that are confusing the issue. Some other observers think that one part of it is falling into another part rather quickly, and that it is the Hydra-Centaurus supercluster that is doing all the attracting that the samurai see.

There are other ways to approach the puzzle. One is to take a map—drawn up, for instance, from infrared satellite data—and use it to calculate the attraction that each galaxy should feel as a result of the others. Dr Amos Yahil of Stony Brook University, New York, and Dr Mark Davis of the University of California at Berkeley have made such calculations. They think that the movements reported by the samurai can be explained by galaxies less than half as far away as the Great Attractor.

Such ideas endear them to cosmologists who are trying to work out why galaxies are there at all—that is, why the universe is not just a smooth cloud of gas with no bumps. Many purported explanations for the bumps, invoking a form of matter known as "cold dark matter", have difficulty in explaining anything larger than a supercluster. Larger scales of lumpiness, such as those implied by the Great Attractor, upset them.

The samurai, at present going their separate ways, are preparing answers. Dr Alan Dressler, of Mount Wilson Observatory in California, hopes to find galaxies beyond where the attractor may be: if they are receding too slowly, it would show that they were being pulled back by the attractor. Dr Donald Lynden-Bell, of Cambridge University, is taking a different tack. He is trying to find out where the night sky is brightest, because it is common sense—and also good physics—to think that that is where the most matter is. It seems to be brightest in more or less the same direction that the samurai came up with for the Great Attractor. It is hard to escape the idea that there is something rather big up there.

Racehorses

Sire traits

COULD the game be up for the Byerley Turk, the Darley Arabian and the Godolphin Barb? All the world's racehorses are descendants of these three Arab chargers, brought into Britain between 1687 and 1729 to copulate with 37 of England's finest brood-mares. Since then, thoroughbred bloodlines have been zealously guarded against outside strains. Result: the most nobly bred animals can be worth up to \$40m. Disquieting fact: the average winning time in the Derby, and other classic races, has not improved at all since the first world war.

One popular excuse for this is that 300 years of breeding from the fastest horses has exhausted their genetic potential. In other words, racehorses are now inbred—an explanation that their low rates of fertility seem to support. Dr Patrick Cunningham and Mr Barry Gaffney, at Trinity College, Dublin, put this theory to a rigorous test.

Begin with heritability, or h^2 , the extent



Genetic favouritism

to which a horse's performance depends on the genes of each of its parents. A mare- h^2 of zero implies that a horse inherits none of its speed from its mother; an h^2 of one means that it inherits the lot. The two geneticists tested heritability by using *Timeform* handicap ratings, which are calculated on past performance. These ratings, expressed in pounds, are meant to represent the weights that horses would have to carry for a race between them to end in a mass dead-heat.

From a study of 31,000 horses racing between 1961 and 1985 (reported in a recent issue of *Nature*), they found that performance is indeed a heritable trait, with a mare- h^2 of 0.39 and a sire- h^2 of 0.79. And they reckoned a genetic improvement in *Timeform* ratings of just under 1% a year—suggesting that racehorses are not too inbred to get faster. But translated into distances, this rate of improvement implies that the winner of the 1977 Derby should "beat" the winner of 1952 by 17 lengths. So why didn't it?

Dr Cunningham admits that his estimates of heritability may be too high because of other, non-genetic factors. For instance, one would expect the offspring of the most valuable sires to get preferential treatment—the cream of the country's trainers, vets and breakfasts—and so perform better on *Timeform* ratings for non-genetic reasons. But he is sure that thoroughbreds have a heritability of at least 0.2.

It may be that although the top thoroughbreds of each generation are not bettering their forebears, the lowly nag in the 2.45 at Folkestone is. Unfortunately, the history of such races is not well documented. Dr Sune Presson, at the Veterinary College in Uppsala, Sweden, suggests that top thoroughbreds have run up against a physiological brick wall—perhaps a limit on the amount of oxygen that muscles can take up—which mediocre horses have yet to reach. Time for some new blood?

BOOKS AND ARTS



McCarthy lends Cohn his ear

Un-American activities

THE AUTOBIOGRAPHY OF ROY COHN. By Sidney Zion. Lyle Stuart; 284 pages; \$18.95.
CITIZEN COHN. By Nicholas von Hoffman. Doubleday; 483 pages; \$19.95. To be published in Britain by Harrap; £12.95

SO HATEFUL was Roy Cohn that it is hard to believe that anybody could find him more repulsive. Both Sidney Zion (in a Cohn "autobiography" based on taped interviews) and Nicholas von Hoffman have done it—and created a mystery. How did such a creep become almost as influential and feared in America as J. Edgar Hoover of the FBI, another closet homosexual, super-patriot and fanatical anti-communist?

Cohn first came to prominence as a young prosecutor in the trial in 1951 of Julius and Ethel Rosenberg on charges of passing America's atomic secrets to the Soviet Union. If Cohn is to be believed, it was a show trial. He disclosed (no, bragged) to Mr Zion that the judge, Irving Kaufman, had told him before the trial opened that he had decided to sentence Julius Rosenberg to death. The judge took longer to make up his mind about Ethel. Concerned that he would outrage public opinion if he sent a mother of two young children to the electric chair, he telephoned Cohn from a public call box

to ask his advice on sentencing. Such considerations did not sway Cohn. He told Judge Kaufman that he was even keener to see Ethel fried than Julius.

This sensational revelation from Mr Zion apart, Mr von Hoffman has produced a better informed as well as a better written book. He is especially good at describing Cohn's starring role in the communist witch- and wizard-hunts in the early 1950s. Young Cohn was chief counsel to Senator Joseph McCarthy in the Senate hearings which, along with those of the House Un-American Activities Committee, destroyed the reputation and livelihood of so many decent Americans. The tainted included even the country's top comedienne. Cohn had planted a story in Walter Winchell's gossip column, published under the headline "Lucille Ball named red." Her husband, Desi Arnaz, had to go before the cameras to plead: "Lucy has never been a communist, not now and never will be... Lucille is 100% American."

Yet when McCarthy was finally ruined by public revulsion against his tactics, Cohn continued to prosper as a fixer, political go-between and the fastest legal gun east of the Alleghenies. Only in the last few months of his life did his excesses (for instance, his routine leaking of his clients' confidences to gossip columnists) lead to his being disbarred in New York.

Cohn was then dying of AIDS. He insisted the disease was liver cancer. Although he was a promiscuous homosexual (the deck of his yacht was often packed with muscular young men wearing bikini briefs stuffed with Kleenex), he had lobbied against a gay-rights municipal ordinance in New York. He was similarly two-faced about his Jewishness, talking of "kikes" and calling his client Samuel ("Si") Newhouse, a newspaper magnate, "Jewhouse" behind his back. This self-hating anti-semitism was bound up with his anti-communism. "Not all Jews are communists," said Cohn, "but most [American] communists are Jews."

Both Mr Zion and Mr Hoffman fail to come up with an even half-convincing explanation of what made Cohn tick. It is an excusable failure. He was spoiled rotten by his mother, with whom he lived until her death, but so are many other men and they remain human. The depths of Cohn's personal inadequacies are unfathomed, and probably unfathomable.

Less excusable is the failure of either author to explain how Cohn achieved public fame and fortune. To be sure, part of his success was based on fear. It took a brave man to tangle with an ally of J. Edgar Hoover, who routinely used Cohn to place defamatory items in the press. But it was the friendship of leading politicians, and the invitations to the White House, that were crucial to Cohn's standing.

The reader of either book is left to juggle with the clues that are presented. Pieced together, they suggest that the extremism of Cohn's political views was an embarrassment to many who used or befriended him. "Roy's idea of cutting down on welfare is to kill a beggar," is how one of his friends put it. But the evidence presented by both these authors also suggests that his patriotism was never in doubt. Nor was the sincerity of his anti-communism. It also helped that he made the right enemies—such as Robert Kennedy, who tried his best to ruin him.

Cohn seems as a consequence to have benefited from a political double standard. Just as many political right-wingers find it hard to be unambiguously critical of South Africa or Chile, so they could not bring themselves to believe that Cohn could be all

BOOKS AND ARTS

bad. He was, with all his faults, seen by them as "one of us". They were wrong. Roy Cohn was as malign as the disease that killed him in the summer of 1986.

Pakistan

The dim-wit who never was

THE POLITICAL ECONOMY OF PAKISTAN 1947-1985. By Omar Noman. KPI; 218 pages; £25

SINCE President Zia ul Haq came to power in Pakistan by military coup a decade ago, academic and journalistic silence has surrounded his rule. That silence is partly explained by his success; initially, hardly anyone expected him to stay. He was made chief-of-staff by Bhutto, it was said, because he was thought too dim-witted to be a threat. Having overturned the predictions, he is usually treated now with a certain caution.

Mr Noman divides President Zia's decade into three phases. These suggest not long-term planning so much as intelligent

flexibility. In the first two years of his rule, from 1977 to 1979, he promised elections which, for reasons he was always able to explain away, never materialised. Then, after he had Bhutto executed in 1979, he adopted two strategies. He cracked down on the political opposition and, at the same time, announced that his government's mission was to turn Pakistan into the Islamic state it had never truly been. Mr Noman and many Pakistanis consider this strategy to be a cynical manipulation of religion to legitimise an illegitimate government.

By 1983 President Zia saw that he had not succeeded. A mini-civil war in Sind proved the growing unpopularity of his government. The regime needed to acquire a democratic face; so, prudently changing the constitution to shift power from parliament to president, General Zia held non-party elections and got himself a parliament and a prime minister. Even those who will never forgive General Zia admit that, compared to other governments they have had, the current one is unobjectionable.

As Mr Noman points out, however, the government has problems which cannot be resolved by nifty political footwork. Increasingly, Pakistanis are retiring into separate ethnic and linguistic camps—a development which makes it more difficult to solve prob-



Much revered Zia

lems through national consensus. The economy is threatened by the government's failure to raise taxes, the decline in job opportunities in the Middle East, and sluggishness of private investment in a country where, after all, nobody is sure what is going to happen next.

The objection to President Zia is not principally material. The country is undoubtedly richer and freer than it was ten years ago, yet Mr Noman seems to feel that

Reading the entrails of 1987

THE Nuffield College election studies are a strange art form. This one—THE BRITISH GENERAL ELECTION OF 1987*—is the 13th in a series dating back to 1945. Their style is usually monochrome to the point of invisibility; the ghost of Theodore White has never passed this way. They contain a good deal of narrative history and critical comment ("It was not one of her best performances"); but they seldom develop new ideas about the British political system. That said, they are invaluable. British politics-watchers are far more indebted to David Butler, the series' principal author since 1951, than most of them probably realise.

The 1987 volume, for example, reports that only 27% of British daily-newspaper readers see a pro-Labour paper; that the Conservatives spent nearly £5m on press advertising during the campaign; that the number of Jewish MPs fell for the fifth election in a row, from a record high of 45 in 1974 to 23 (of whom 16 were Tory, only 7 Labour); that the phalanx of Old Etonians on the Conservative benches continues to decline (there are now 43); and that, whereas the proportion of ex-manual workers on the Labour benches usually rises when Labour loses (as the party is forced back on its safest seats), the

proportion actually fell in 1987 to 28%, one of the lowest figures in Labour's history. Mr Butler and Mr Kavanagh also report that Mrs Margaret Thatcher and Mr Norman Tebbit, the Conservative party chairman, were out of sorts with each other before the 1987 campaign started and that their relations steadily worsened during it; but everyone knew that already.

The most significant findings in the 1987 study—printed, inappropriately, in small type at the back of the book—appear in a detailed analysis of the election results by two less well-known academics, John Curtice and Michael Steed. They document a number of developments—and non-developments—that are likely to go on being important in the 1990s. Britain, they note, is increasingly divided into two political zones, with Labour doing significantly better in Wales, Scotland and the north of England, the Conservatives better in the midlands and the south (especially in metropolitan London north of the Thames). One consequence of Labour's continuing strength in the north is that the Social Democrats' original 1981 aim of biting deep into the traditional working-class Labour vote (which the Liberals on their own could never do) has come to nothing.

What Messrs Curtice and Steed call the "denationalisation" of British politics is also reflected in such phenomena as the rise of personal and tactical voting. Personal votes, largely on the basis of self-publicity and constituency service, probably helped the Tories hold on to half a dozen seats. But tactical voting cut the other way. The pattern is complicated, but many Labour voters appear to have switched tactically to the Alliance in places where Labour finished a poor third in 1983, and likewise more Alliance voters than might have been expected appear to have switched to Labour where the Alliance was clearly out of the race.

When necessary, Mr Butler's two colleagues are also good at balloon-puncturing. Left-wing Labour candidates ("the loony left") did not do worse at the polls last June than their more moderate colleagues: the Curtice-Steed calculations show that left-wingers, on average, put Labour's vote up by 1.2% more than right-wingers (although almost certainly for reasons—such as regionalism—having nothing to do with ideology). Left-wingery hits Labour hard, but across the board. Electors who, despite the party's national image, have decided to vote Labour seem largely unbothered by the local Labour standard-bearer's political colouration.

*Macmillan; 379 pages; £29.50.

the past decade has been an insult to Pakistan:

The hypocrisy is rude and has an element of farce. Western culture and values are denigrated, yet \$7 billion are acquired from the West in exchange for political allegiance; liquor is banned, but destructive drugs are permitted to be grown, processed, exported and consumed domestically because the revenues are too lucrative; ... a regime formed under a self-proclaimed transitory mandate finds itself, a decade later, devising new strategies to prolong its rule.

Mr Noman's clear and well-written book fills a gap on the political shelves. Its weakness—the absence of a general thesis—is understandable: Mr Noman writes about a country that obstinately refuses to fit into patterns or fulfil predictions.



Fyodor Chaliapin asso glorioso

CHALIAPIN. By Victor Borovsky. *Hamish Hamilton*; 630 pages; £25. *Alfred Knopf*; \$45

WHEN God created Fyodor Ivanovich Chaliapin, it was said, He must have been in a good mood, for he brought joy to all. Yet there was little joy in the great singer's own early years. Born to a drunken peasant father (he carried the legend "Origin: peasant" on his passport) and an illiterate, exhausted mother, he came close to starvation before being rescued by Usatov, a formidable Russian tenor who gave him, in a year, all the formal education he was ever to receive in music, literature, art and even table manners. By the time he was 25 he was singing at the Bolshoi and, on his first night, took more than 30 curtain calls.

It is hard to pin down theatrical genius, but Mr Borovsky's method is better than most. Using a copious library of reviews and reminiscences and a magnificent collection of photographs, he has recreated each of the principal roles as they were played by the great man. In so far as Chaliapin's magic can be distilled, it contained three elements: a voice of wonderful, natural flexibility and richness in which the sense of a word was never sacrificed for the sake of a beautiful sound; an unparalleled skill with make-up that transformed his appearance and a dramatic talent that would virtually hypnotise an audience. "With Chaliapin on the stage," ran his obituary in *The Times*, "we neither watched nor listened: we experienced with him."

Chaliapin was a giant among opera singers. He was appreciated by Chekhov and Tolstoy, admired by Rimsky-Korsakov and Stanislavsky and loved by Gorky and Rachmaninov. When he left Russia five weary years after the Revolution, only American critics expressed any reservations

about his supremacy. His one frustration was the impossibility of assembling a company that could achieve his own high standards. He dwarfed them all and was destined always to be the star, when his ambitions were for the success of a production as a whole. He may have been a little ahead of his time.

For so thoroughgoing a researcher, Mr Borovsky is curiously vague about some things—Chaliapin's attitude to and behaviour during the Revolution, for instance, his movements after leaving Russia and his private life. But there are compensations. One such is the description of Chaliapin's first marriage to Iola Tornaghi, an Italian ballerina, in 1898. After their rumbustious village wedding the young couple retired, only to be awakened at dawn by a group of friends performing a cacophonous serenade on pots and pans, stove-lids and buckets. "Get up!" they shouted. "Let's go into the woods and look for mushrooms." The conductor of the "orchestra" was Rachmaninov.

Cinema meets soap opera

The tyranny of money

MANILA

MORE talented film makers are at work in the Philippines today than at any time since the second world war. Few, however, are behind the cameras, and those who are have gone down-market. Lino Brocka, the director with the biggest international reputation, once made disquieting films about the urban poor who live in cardboard houses and pick a living from rubbish tips; his film "Bayan Ko" was the story of a poor man who, obliged to pay his bills to get his wife into hospital, is forced to turn to crime. Mr Brocka now makes soap operas. His next is to be about a runaway nun imprisoned on suspicion of murder, whose bastard child (fathered by a man dying of leukaemia) is stolen by a wicked warder. It is called "Lord, Why Me?" Why, indeed?

Even in the most repressive years of the Marcos era, outspoken and uncompromising films could be made. Mike De Leon's "Manila By Night", about pimps and prostitutes at their work, so infuriated Imelda Marcos (who was then officially "in control" of metropolitan Manila) that she insisted on changing the title to "The City by Night" when the film was shown in the Philippines. There was no question, however, that it would not be shown. Now Mr De Leon seems to have abandoned production.

Film makers have not lost their nerve, although there is an element of caution about undercutting the fragile Aquino regime; they have lost their financial incentive. Historically, films have been a powerful

cultural force in the Philippines, encouraging among other things the establishment of Tagalog as the national language. The Marcoses, hoping to foster an industry in their own image, poured money into cinema. They built a Film Centre (now a crumbling white elephant) to house a grandiose film festival, they set up the Experimental Cinema of the Philippines under the control of their daughter, Imee, allegedly to make quality films, and they authorised a system of tax exemptions, rebates and rewards to encourage production.

Much abuse arose from the Marcoses' flirtation with cinema. The Film Centre became a home for expensive pornographic film shows from which the government pocketed the takings, while the rewards for merit, which could amount to a total rebate of the stiff amusement tax, were diluted by kick-backs and rake-offs—officially described as "overheads".

For all that, some fairly good films were made, and the producers at least got something. When Mr Marcos went, they were exposed again to a complex of levies that cumulatively amount to 42% of the box-office gross. That gross is tiny by western standards, since it costs only about 60 cents to see a film even in the capital; and the cut taken by exhibitors, especially in the film-hungry provinces, is far more than their fair share. Vast numbers of un-numbered, unreported and untaxed tickets are sold that never return a cent to the producer, making

BOOKS AND ARTS

it hard to chalk up a profit however popular a film may be.

As many people as ever crave the kudos and glamour of being a movie producer. New ones come and go faster than the eye can count, but only three companies have been consistently successful: Regal, Viva and Seiko. They account for about 80% of all the profitable Philippine films. But they take no risks. They make movies like "Whisper to God" in which the heroine, twice raped, is blinded in a car accident, receives a corneal graft from her lover who is dying of cancer, marries a rich businessman only to see him and her illegitimate child gunned down at the wedding by a jealous secretary, but prays to God for a miracle by which the child's life is spared. It is the box-office sensation of the year; everybody is trying to copy it. Even Lino Brocka.

Good films will not return to the Philippines until somebody makes it worthwhile to take risks again. In practice, this means some relaxation of a confiscatory tax structure. Film makers, too, could do more to help themselves. Eddie Romero, a veteran pragmatist and survivor, may be pointing the way in the co-production deals he has struck with film makers in Australia and China. His "King and Emperor", a vast fresco about a visit by the King of Sulu to Beijing in 1415, is not a great film; but it kept its director busy and did not compromise his standards.

Edgar Degas

A word with Titian

PARIS

AS THE huge Degas retrospective at the Grand Palais winds down and prepares to move on (to Canada in June, New York in September), how does the painter stand? His ballerinas are among the most reproduced of all Impressionist images; but as Degas himself said, they were only a pretext for his lifelong obsession with the rendering of movement. And although he has been identified with the Impressionists, their ideas were largely at odds with his own. If he were the government, he once declared with characteristic acerbity, he would have a brigade of police keep an eye on people who painted from nature.

More than most of his colleagues, Degas was firmly attached to older artistic values. His early works, such as "The Young Spartans" (in the National Gallery in London) are large historical paintings based on classical subjects, although even here, prefiguring his dancers, he paid meticulous attention to the attitudes and gestures of bodies. All his life his avowed master was Ingres, whose advice "to draw lines, many lines", he took to heart.

Bejazzled

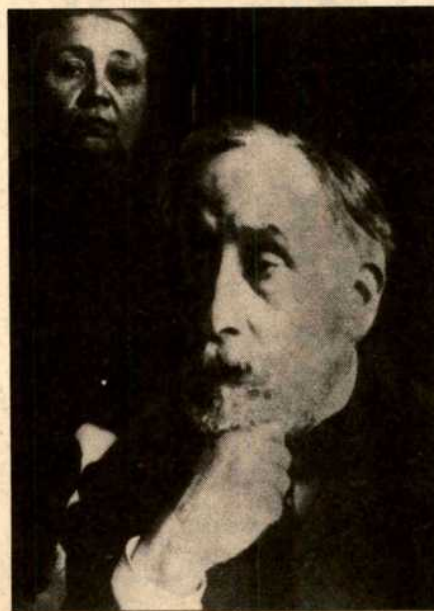
IN RECENT years the rediscovery of Charlie ("Bird") Parker, who played some of the best alto saxophone ever heard, has become a small industry. Feeding that industry is the continual discovery of original recordings, not made in the studio but captured on amateur taping equipment in the clubs where he was performing. These are curious, scrubby, surreptitious things, but they are sacred to the growing numbers who wish to hear every possible note that Parker played. (In his miserable lifetime, he would have been gratified.) To the fans, there are not many caches better than the 51 shellac discs and 14 rolls of tape that turned up last week in California.

The taper of this new material was Dean Benedetti, who died young in 1957 and left the recordings with his brother. He used to wire the clubs carefully himself, infiltrate his microphones through the ceiling and then lock himself in the

lavatory with his recorder. He recorded only Parker, and could not get much that was worthwhile even of him; but Mosaic Records in Connecticut, which puts out limited-edition records of rare jazz, is extremely excited. Jazz academics will pore over it.

Less exciting, but more useful, is the news that came almost the same day from the Smithsonian Institution in Washington, DC. The Smithsonian has acquired a huge cache of Duke Ellington material, including tapes of his band made at Ellington's expense (not, presumably, in the gents) and original orchestrations of his music. There are hundreds of these, ranging from "Awful Sad" through "Zurzday", and it should now be possible, after years of guessing, to play Ellington's longer works in the way he intended. At least Ellington wrote it all down. Parker had to be caught out of the air, and half the present cult, it seems, lies in the fun of the catching.

For him, his dancers provided a connection with antiquity: the only way, he once said, "to rediscover the movements of the Greeks." Like the Greeks, too, he was obsessed with finding the structure beneath the surface. An entire room at the Grand Palais is devoted to his talent as a sculptor. This was something he kept secret, not least because the works were exploratory and often fell to pieces in his hands. "The Little Dancer" of 1881, which a contemporary called "the sole truly modern effort in sculpture" was the only model he ever exhibited.



Composition with housekeeper

He also dabbled in photography, which intrigued him with its power to capture a moment and create, apparently by chance, a composition. He tried to do the same in paint all his life, until blindness overtook him.

At the heart of Degas's work lies his controversial rendering of women. Some of his most striking creations are devoted to capturing them in unguarded moments and unconventional attitudes. In his time, such treatments were criticised as unflattering at best, at worst cruel. He was accused of misogyny. But in his weary laundresses at work or stocky women at their toilettes, there is as much tenderness as in his dancers. His point of view is one that is more acceptable to modern critics: that there is beauty in any movement of the body, however casual and unromantic, and that it is the artist's purpose to make that beauty visible.

It is clear from this exhibition that Degas led nineteenth-century painting away from both the insipidness and pretension of the Academy and from the potential formlessness of Impressionist orthodoxy. In doing so, he created a modern classicism. Degas would have concurred wholeheartedly with Cezanne's desire to "make of Impressionism the art of the museums." It was with the art of the museums that he identified his own work. He once objected to a friend's reference to "you revolutionary painters." "Don't say that," he insisted. "We are tradition itself. It can't be said too often. And perhaps Titian will say a few words to me as he steps into his gondola."

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swissair 

ECONOMIC AND FINANCIAL INDICATORS

1

OUTPUT, DEMAND AND JOBS Japan's unemployment fell slightly in March to 2.6% of its labour force, down from a peak of 3.2% in May 1987. Italy's jobless rate was 15.7% in the same month, more than a percentage point higher than a year ago. In every other country in our table unemployment has fallen over the past year, though West Germany's rate rose slightly in April, to 8.9%. The 12-month growth in Canada's industrial production slowed in February to 5.7%. In the first quarter of 1988 Spain's retail sales were 14.0% higher than in the same period last year.

% change at annual rate

	industrial production		GNP/GDP		retail sales [volume]		unemployment % rate	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year	latest	year ago
Australia	+9.2**	+6.2** Dec	+6.1	+4.6 Q4	-0.5	+1.9 Q4	7.4 Mar	8.4
Belgium	+1.7	+0.7 Dec	na	na	+3.5	-0.6 Dec ‡	10.9 Mar*	11.8
Canada	+3.4	+5.7 Feb	+6.3	+5.7 Q4	+1.9	+5.1 Feb	7.8 Mar	9.6
France	+2.6	+2.9 Feb	+1.6	+2.5 Q4	+1.5	-1.1 Jan	10.3 Mar	10.8
W. Germany	+3.0	+3.1 Feb	+2.9	+2.3 Q4	+6.7	+6.3 Feb	8.9 Apr	8.9
Holland	-7.3	-2.8 Feb	+9.6	+1.5 Q3	+7.9	+4.9 Dec ‡	14.0 Mar	14.2
Italy	+11.5	+7.8 Jan	+1.8	+2.4 Q3	+8.1	+2.8 Sep ‡	15.7 Mar*	14.6
Japan	+14.0	+12.8 Mar	+7.0	+5.3 Q4	+6.4	+8.4 Jan	2.6 Mar	2.9
Spain	-3.4	+4.0 Feb	na	na	+15.5	+14.0 Q1 ‡	20.1 Mar	20.4
Sweden	-11.2	-1.4 Feb	+3.7	+2.4 Q4	-9.1	-0.1 Jan	1.8 Mar*	2.2
Switzerland	+24.1	+5.6 Q4	+2.1	+2.7 Q4	+3.9	-0.6 Dec ‡	0.8 Mar*	0.9
UK	-0.8	+3.3 Feb	+2.7	+4.3 Q4	+5.1	+7.1 Mar	9.0 Mar	10.9
USA	+3.9	+5.7 Mar	+2.3	+3.5 Q1	+6.6	+1.2 Mar	5.6 Mar	6.6

na index deflated by CPI. ** New series.

PRICES AND WAGES Japanese consumer prices rose by 0.7% in the year to March, and French prices by 2.5%. West Germany's inflation rate edged up to 1.1% in April. The wages of Swedish workers were 6.2% higher in January than a year before. Workers in Holland, by contrast, got only a 0.5% pay rise in the 12 months to March. Canada's wholesale prices rose by 4.6% in the year to March, and hourly earnings by 4.1% in the 12 months to February.

% change at annual rate

	consumer prices*		wholesale prices*		wages/earnings†	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year
Australia	+7.2	+7.1 Nov	+7.4	+6.7 Dec	+9.8	+5.8 Nov*
Belgium	+1.7	+1.0 Apr	-1.2	-0.8 Jan	+15.4	+2.8 Q4*
Canada	+3.3	+4.1 Mar	+3.0	+4.6 Mar	+6.7	+4.1 Feb*
France	+2.0	+2.5 Mar	+4.3	+3.1 Q4	+3.3	+3.5 Jan*
W. Germany	+2.4	+1.1 Apr	+1.3	+0.6 Mar	+0.6	+2.6 Feb
Holland	-3.2	+0.6 Mar	-1.3	-0.7 Jan	+0.7	+0.5 Mar
Italy	+3.7	+4.9 Mar	+4.4	+4.2 Feb	+8.5	+7.1 Dec*
Japan	-2.1	+0.7 Mar	-4.6	-1.0 Mar	-0.7	+2.2 Feb
Spain	+5.0	+4.5 Mar	+3.2	+2.8 Feb	+8.0	+9.1 Feb
Sweden	+5.3	+5.5 Mar	+5.8	+4.6 Feb	+9.4	+6.2 Jan*
Switzerland	+3.2	+1.8 Mar	+2.1	+1.5 Mar	nil	+2.1 Q4*
UK	+2.0	+3.5 Mar	+5.5	+4.1 Mar	+9.9	+8.5 Feb
USA	+2.4	+3.9 Mar	+0.7	+1.8 Mar	+2.8	+2.8 Mar

* Inflation rates in manufacturing except Australia, weekly earnings; Japan, and Switzerland, monthly earnings; Belgium, Canada, Sweden and USA, hourly wages; UK, monthly earnings for all employees.

The Economist

COMMODITY PRICE INDEX

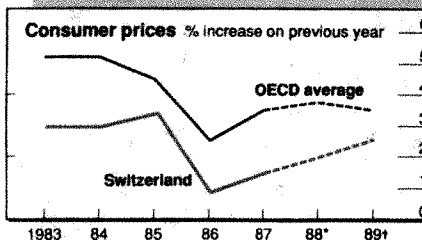
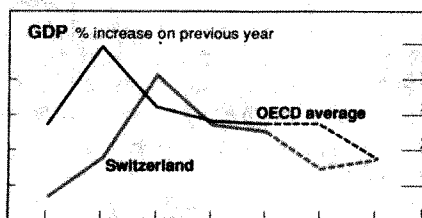
The International Cocoa Organisation is trying to persuade Malaysia to join the cocoa agreement. Malaysia has trebled its cocoa output over the past five years to 190,000 tonnes, making it the third-largest producer this season (behind the Ivory Coast and Brazil). Without Malaysia's membership the ICCO cannot implement its plan for producers to store cocoa at source. But membership would make Malaysia subject to a \$30 a tonne levy on its exports, and so reduce its profits. Malaysia has hinted that it might join the pact if Brazil, the second-biggest tin producer, would join the tin agreement. This would put a restrictive quota on Brazil's competing tin exports.

1985=100

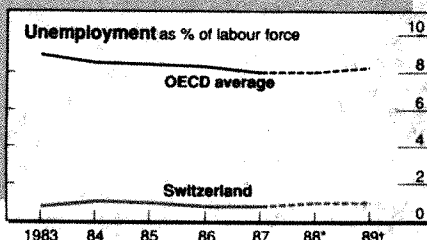
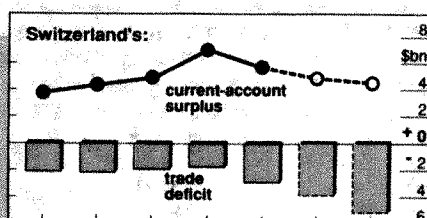
	Apr 26	May 3†	% change on one month	% change on one year
Dollar index				
All items	143.0	142.5	-5.9	+31.4
Food	105.8	104.7	-0.4	+10.0
Industrials				
All	180.0	180.0	-8.8	+47.9
Nfa ‡‡	152.4	150.7	+0.9	+16.2
Metals	199.6	200.7	-13.3	+73.2
Sterling index				
All items	97.8	97.6	-5.5	+18.5
Food	72.3	71.7	nil	-0.7
Industrials				
All	123.1	123.3	-8.4	+33.5
Nfa ‡‡	104.2	103.2	+1.4	+4.8
Metals	136.4	137.5	-12.9	+56.2
SDR index				
All items	105.0	104.8	-5.4	+25.3
Food	77.6	77.0	+0.1	+5.0
Industrials				
All	132.1	132.4	-8.3	+41.1
Nfa ‡‡	111.8	110.9	+1.5	+10.8
Metals	146.5	147.7	-12.8	+65.1
Gold				
\$ per oz	447.75	445.75	-1.3	-2.6
Crude oil North Sea Brent				
\$ per barrel	17.20	16.12	-6.3	-15.8

† provisional ‡‡ Non-food agriculturals

THE SWISS ECONOMY Switzerland's recent economic performance has been the envy of most other European countries. Last year it had the lowest unemployment rate (0.8%) in the OECD, one of the lowest inflation rates (1.4%), and a healthy current-account surplus. Growth, which had lagged behind other industrial countries in the 1970s and early 1980s, has picked up to an average of 2.7% over the past three years—above the OECD average. However, in its latest report on the Swiss economy, the OECD expects growth to slow to only 1½% in 1988 and 1¼% in 1989, mainly because of weaker investment. It guesses that the current-account surplus will fall from \$5.8 billion in 1987 to about \$4.5 billion by 1989 as the rise of the Swiss franc against the dollar continues to hold back exports.



Source: OECD



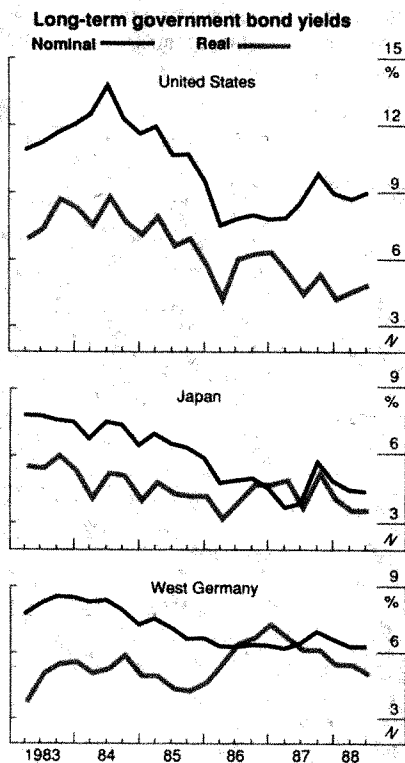
* Estimate † Forecast

Footnotes applicable to all tables. All figures seasonally adjusted except * not seas. adj. † Average of latest 3 months compared with avg. of previous 3 mos, at annual rate. na not available.

ECONOMIC AND FINANCIAL INDICATORS

2

BOND YIELDS Between 1984 and 1986 yields on America's long-term government bonds almost halved, to around 7½%. They have since risen to just over 9% on fears of higher inflation. But real bond yields (calculated here by deflating nominal yields by the 12-month change in consumer prices) have fallen from 6½% in late 1986 to 5% today. In 1984 real yields stood at 9% in America. In Japan and West Germany, by contrast, real bond yields have hardly budged since 1984 because inflation has fallen along with nominal yields. Indeed, in 1986 falling prices pushed real yields higher than nominal ones.



WORLD BOURSES Prices in Stockholm rose 3.3% during the week to their highest level since the October crash; Stockholm is this year's star performer with a 30% rise (in dollar terms) since December 1987. This year's worst performer, so far, is Italy—down 5% in dollar terms.

Stock price indices	1988		% Change on				
	May 3	high	low	one week	one year	record high	31/12/87
* May 2							
Australia	1444.6	1467.6	1170.7	+ 0.2	- 19.3	-37.4	+10.2
Belgium	4726.8	5043.1	3608.4	+ 1.5	+ 3.2	-12.7	+29.4
Canada	3351.3	3402.4	2977.9	+ 0.2	- 11.0	-18.5	+ 6.1
France	310.7	312.5	251.3	+ 0.9	- 31.1	-32.5	+10.7
W.Germany	1346.2	1457.5	1207.9	- 1.1	- 25.4	-40.9	+ 3.6
Holland	245.9	280.3	205.7	- 0.4	- 11.0	-26.4	+17.8
Hongkong	2602.6	2684.1	2223.0	+ 0.6	- 4.1	-34.1	+13.0
Italy	496.8	545.1	423.9	- 2.3	- 34.5	-45.3	+ 1.8
Japan	27669.7*	27669.7	21217.0	+ 1.6	+ 16.8	nil	+28.3
Singapore	968.9	969.4	833.6	+ 1.3	- 15.4	-35.6	+17.7
South Africa	1469.0	1564.0	1387.0	- 1.3	- 20.4	-35.2	+ 1.8
Spain	271.8	281.1	225.5	- 0.2	+ 28.1	-16.5	+19.6
Sweden	2858.1	2858.1	2148.5	+ 3.3	+ 3.6	-12.5	+31.7
Switzerland	518.7	539.5	466.6	+ 0.8	- 11.8	-28.9	+ 9.3
UK**	1807.2	1855.5	1694.5	+ 0.4	- 12.5	-26.0	+ 5.5
USA	2058.4	2110.1	1879.1	+ 0.7	- 8.0	-24.4	+ 6.2

**New series (FT-SE 100)

†Converted at financial close

MONEY AND INTEREST RATES The 12-month rates of growth in both measures of Britain's money supply quickened slightly in the year to March: M1 grew by 20.8%; M3 by 20.9%. Banks in Sweden raised their prime lending rates by half a point, to 12%.

	Money supply		Interest rates % p.a. (Tuesday, except bonds which are previous Friday)							
	% rise on year ago		Money market		Commercial banks		Bond yields		Eurocurrency	
	Narrow [M1]	Broad†	Overnight	3 months	Prime lending	Deposits 3 months	Gov't long-term	Corporate	Deposits 3 months	Bonds
Australia	+18.5	+14.7	Feb	na	na	na	na	na	11.31	12.48
Belgium	+ 7.7	+12.7	Q3	5.88	6.10	8.50	5.75	7.66	7.68	5.94
Canada	+ 5.9	+ 6.7	Mar	8.50	9.00	10.25	7.50	10.37	10.51	8.88
France	+ 3.1	+ 9.2	Jan	7.38	8.00	9.45	8.13	9.26	9.78	8.38
W. Germany	+10.5	+ 6.1	Mar	3.25	3.40	5.50	3.09	6.30	5.90	3.50
Holland	+ 7.7	+ 5.8	Jan	3.97	4.06	5.75	3.50	5.95	6.49	4.00
Italy	+ 9.0	+ 9.5	Nov	10.25	10.88	12.63	na	10.41	10.76	10.25
Japan	+ 9.8	+12.4	Feb	3.31	3.80	3.38	1.76	4.50	4.39	4.06
Spain	+10.3	+14.0	Dec	10.99	11.48	15.25	6.50	12.22	13.75	9.75
Sweden	na	+ 5.4	Feb	10.15	10.65	12.00	10.43	11.35	12.20	10.38
Switzerland	+14.2	+11.3	Jan	2.13	2.32	5.25	1.50	3.97	4.29	2.32
UK	+20.8	+20.9	Mar	7.25	8.38	9.00	8.28	9.34	10.55	8.41
USA	+ 4.0	+ 5.8	Mar	6.38	7.01	8.50	7.09	9.11	9.52	7.31

Other key rates in London 3-mth Treasury Bills 7.8%, 7-day Interbank 7.7, clearing banks' 7-day notice 3.3%. Eurodollar rates (Libor): 3 mths 7.3%, 6 mths 7.5%.

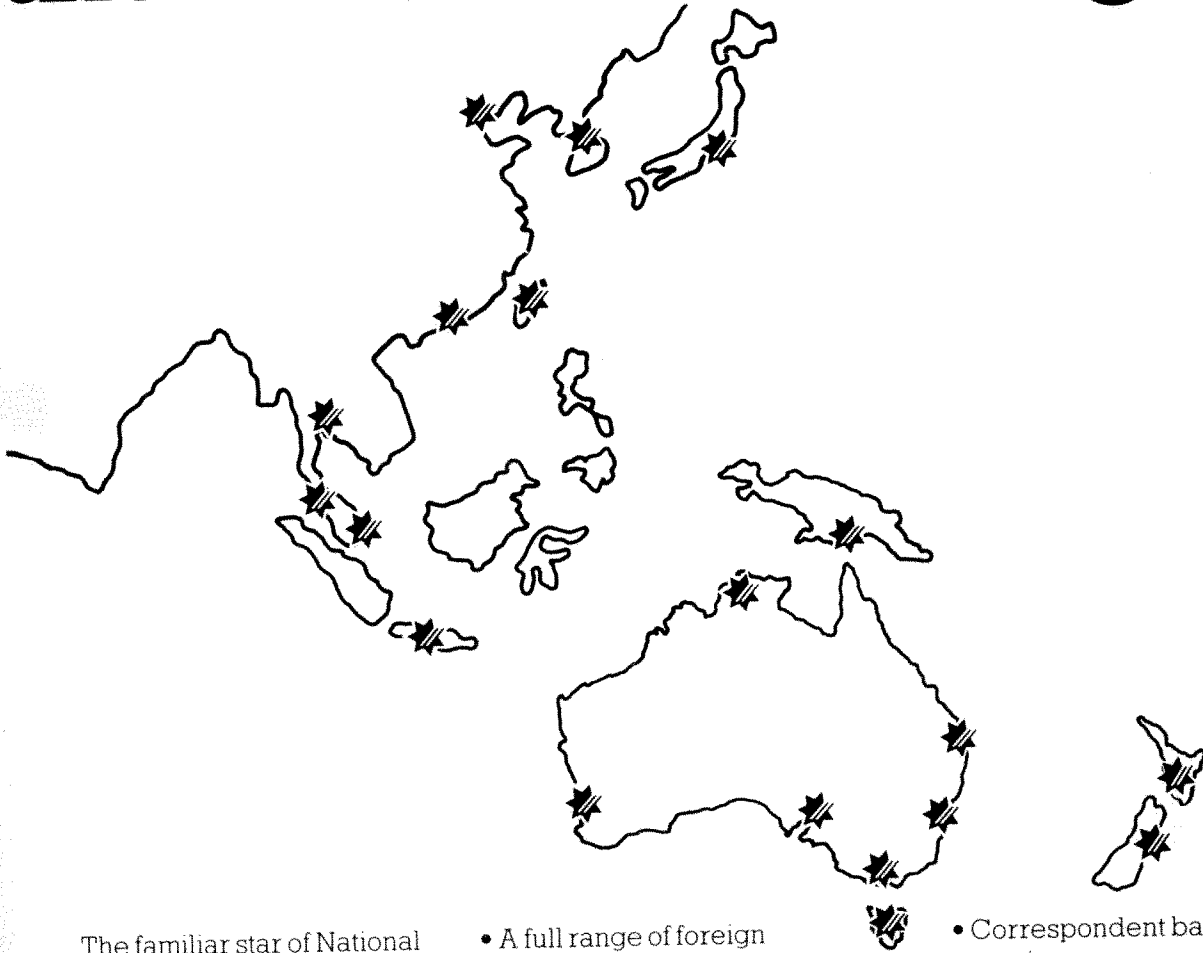
†M2 except Australia, Canada, Spain, Switzerland, USA, UK, W. Germany M3, Japan M2 + CDs. Definitions of interest rates quoted available on request. Sou Bank of Bilbao, Chase Manhattan, Banque de Commerce (Belgium), Nederlandse Credietbank, Credit Lyonnais, Svenska Handelsbanken, ANZ Bank, Credit St First Boston, Wharton Econometrics. These rates are indicative only and cannot be construed as offers by these banks. ** Last week's rates.

TRADE, EXCHANGE RATES AND RESERVES Britain's current-account deficit fell to \$470m in March, from an average of \$1.4 billion in the first two months of the year, but its 12-month deficit rose to \$7.4 billion; its 12-month visible-trade deficit rose to \$20.5 billion—the second largest (after America's) in the world. Sterling rose on the March figures, but still finished the week slightly lower against the dollar and in trade-weighted terms. The dollar's trade-weighted value rose 0.2% during the week. The yen's and the D-mark's remained unchanged.

	trade balance†		current-account balance \$bn	trade-weighted†† exchange rate		currency units per \$		currency units			foreign reserves††	
	latest month	latest 12 months	latest 12 mths	latest	year ago	latest	year ago	per £	per SDR	per ecu	Feb	year ago
Australia	- 0.03	Mar	- 0.1	- 8.5	Mar	57.0	55.0	1.31	1.41	2.45	8.6	5.3
Belgium	- 0.32	Dec	- 0.1	+ 2.6	Q3	100.4	100.3	35.1	36.8	65.7	9.4	5.8
Canada	+ 1.06	Feb	+ 7.5	- 7.3	Q4	81.2	76.4	1.23	1.34	2.30	9.6	5.7
France	- 0.91	Feb	- 5.3	- 4.5	Q4	71.1	71.7	5.70	5.92	10.7	34.8**	29.8
W. Germany	+ 6.54	Jan	+ 67.1	+ 44.6	Jan	148.7	147.4	1.68	1.77	3.14	73.3	62.4
Holland	- 0.01	Dec	+ 1.6	+ 2.5	Q3	137.7	135.6	1.88	1.99	3.52	15.2	11.7
Italy	- 0.86	Dec	- 8.7	+ 5.9	Q1§	46.3	47.9	1248	1267	2336	30.8	24.0
Japan	+ 8.45	Feb	+ 94.2	+ 83.8	Feb	245.4	226.9	125	139	234	83.3	51.7
Spain	- 1.60	Mar	- 16.1	+ 0.6	Mar	52.2	48.6	111	124	207	30.4**	15.2
Sweden	+ 0.48	Mar	+ 3.7	- 1.6	Feb	69.0	68.7	5.88	6.20	11.0	8.5	7.6
Switzerland	- 0.19	Jan	- 5.1	+ 7.0	Q4	174.7	175.5	1.40	1.45	2.61	24.4	18.8
UK	- 1.57	Mar	- 20.5	- 7.4	Mar	78.1	73.5	0.53	0.59	—	39.0	19.3
USA	-13.83	Feb*	-171.2	-160.7	Q4	92.7	99.7	—	—	1.87	32.0	38.3

†Australia, France, Canada, Japan, and UK imports fob, exports fob. All others cif/fob. †† Bank of England index 1975 = 100. †† Excluding gold. * Not seasonally adjusted. ** January, \$1987.

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STAND TALL
A survey of South Korea **26 MAY** after page 62

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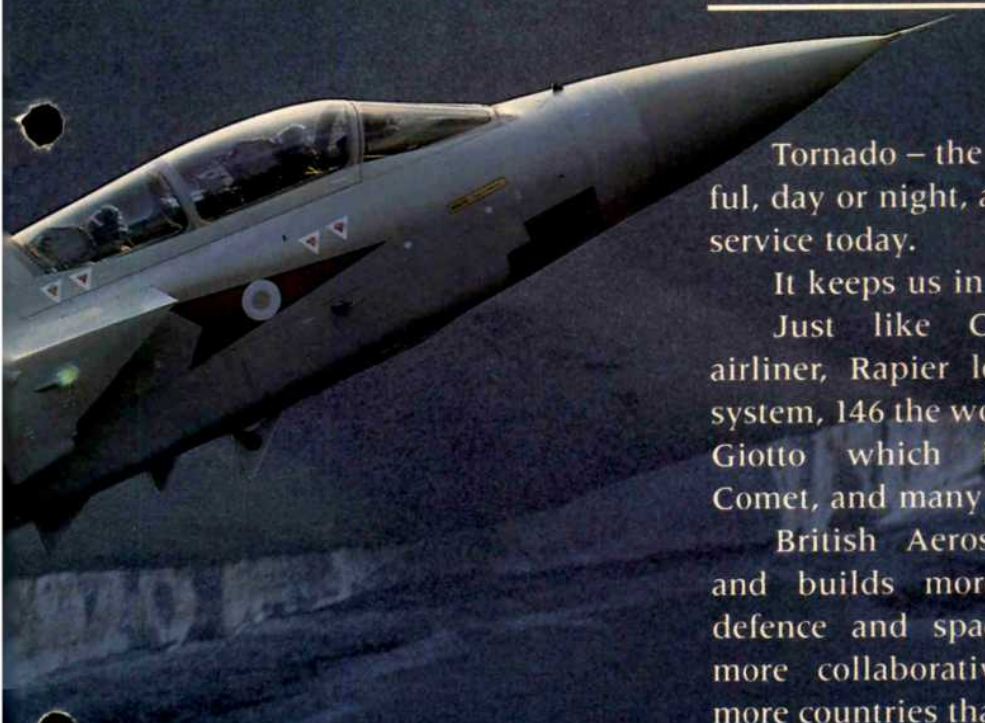
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Parochial pound

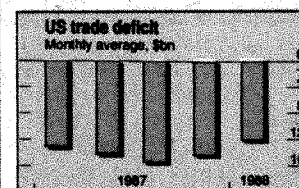
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America's big brokers lost a chance by pretending to be investment banks, page 87.

Plague centre

Take Africa's AIDS seriously, page 16.

LETTERS

Set the hospitals free

SIR—A warm welcome on joining the growing ranks of those who believe that an essential element of the now inescapable reform of the National Health Service must be to "set the hospitals free" (April 30th).

You need to face up to the problems which would arise if health authorities were paymasters for both hospitals and general practitioners. Would they be



financed on a per person basis? Would payments be weighted to take account of differences in age structure and sickness rates? What happens when an authority runs out of cash? Do you seriously believe that hospitals would bid below the cost ceilings for treatments or gracefully accept closure when, by whipping up political pressure, they could extract more cash from the government? So what would be new? As you recognise, an imperfect market indeed.

You get into this quagmire because you refuse to recognise

that, when every allowance is made for the scope for further NHS savings, as Britain needs to cope with remorselessly rising demand. You tiptoe up to this when you concede that Britain's health spending, now 6% of GDP, will have to move "perhaps one percentage point closer to the average for the rest of Europe (9%)". Even that small increase would represent some £5 billion, or a 4p increase in the basic income-tax rate. Surely not *The Economist's* policy?

When our European neighbours are spending twice as much as us, we must find a system that offers the prospect of generating a 50% increase in total spending and provides a mechanism for coping with future increases in demand without the political and fiscal agonies we suffer at present. You are right to suggest that such a system could not come from earmarked taxes, opting out or tax relief for private health insurance. It could come from up-dating a proposal made by a British Medical Association committee in 1970—health credits for all, with encouragement for "topping-up" and the enrolment of the GP as the budget-holder.

RAY WHITNEY
London House of Commons

SIR—In a city I know well, where the choice of hospitals is wide, most women doctors elect to have their babies in the maternity unit with the worst perina-

tal mortality. Clinical excellence attracts informed consumers. The perinatal mortality figures at that hospital are awful because its outstanding reputation means every big problem from miles around ends up there. This example has many parallels. Any surgeon can make his operative success look better by accepting only those cases he thinks will do well. Dealing with difficult clinical problems not only reduces the overall success of treatment but also gets pretty expensive. Under your scheme the unfortunate centre of clinical excellence would presumably be for the chop because too many patients fail to get better at too high a cost.

If I were a hospital manager under your regime I would live by simple rules. First, no emergency room (who knows what this might bring in and what the patients might cost). Second, accept only patients whose chance of successful treatment and a short hospital stay is high. The doctors in this hospital would gain considerable experience of treating uncomplicated conditions. Costs would be predictable and contained and my hospital would flourish. And what of St Elsewhere's, accepting all comers at greater cost and whose doctors can cope with most things but are not always successful? Well, they closed. Too bad, because I have a suspicion about which hospital you would rather go to if you were really sick.

PETER RUBIN
University Hospital
Nottingham

Opening the doors

SIR—I read with a certain wry humour the interesting analyses of the emigration problems encountered in Japan and Canada respectively (April 16th).

Japan stands condemned for severely limiting immigration to only the highly talented, and Canada, presumably, for slowly addressing the problem of a growing onslaught of bogus refugees. In fact, Japan is actually simply doing what every other nation, including Britain claims to do: allowing immigration for those who have skills not to be found locally. Canada's "problem", however, seems to be that it is slowly and tortuously putting its house in order in

hopes of achieving a more rational system, one more based on skills.

The Japanese had 87,877 "new workers entering Japan in 1987", according to your own figure which, I recall, is not so different from the total for Britain, albeit a smaller nation and economy. Where the two nations do differ, and Japan differ from most of the western world is the emphasis it puts on skills whether entertainment, business or whatever.

While in London last autumn I found the British people extremely hospitable to foreigners British employers are even more so, particularly for anyone like myself with an MBA and years of experience with financial applications software. But getting approval from the Home Office to work the magic one year in Japan was simply impossible. Perhaps I would have been smarter to have tried Tokyo.

Montreal MICHAEL SMIT

Popper's democracy

SIR—In his article on democracy (April 23rd), Professor Sir Ka Popper expresses a profound distaste for political parties, preferring a system in which a representative can vote according to his conscience. May I remind him of a real life example of country where this happens?

In the United States only the president is elected on the basis of national issues. There is no such thing as national party government. Parties are merely indicators of the views and values of the candidate.

As we have seen recently over the American budget deficit episode, members of Congress know that their interests lie in pleasing their own constituents rather than serving the country as a whole. This may be wonderful for the people of North Dakota who can, thanks to Senator Quentin Burdick, rejoice in the fact that the federal government is to buy \$10m-worth of surplus sunflower oil produced in the state. However, while North Dakota may rejoice, the rest of the world can only be sickened by the stupidity of the American Congressional electoral system which forces congressmen to wave millions of dollars in front of their constituents in the hope of getting re-elected.

A responsible national pa-



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Middlesex Polytechnic

LETTERS

government, such as the current Thatcher administration in Britain, has been able to exert strict party discipline in order to take the tough decisions which have at last hauled Britain out of the economic mire.

Hayes,
Middlesex JAMES LLEWELLYN

SIR—I find Sir Karl's juxtaposition of anarchic proportional representation with the virtuous and stable Anglo-Saxon two-party system polarising and misleading. While hailing the flexibility and efficiency of the British and American systems, Sir Karl glosses over the unrepresentative results of wasted votes and ignores the dangers of gerrymandering.

He alleges that proportional representation turns the representative into a "voting machine" for his party, thus robbing him of responsibility to his electorate. Yet party-discipline appears just as rigid in Britain as in many European countries with proportional representation. The only difference is that, unlike his British counterpart, the conscientious politician in continental Europe can break away and form a new party with a realistic chance of getting elected.

Many intermediate possibilities of democratic elections are ignored. Multi-member constituencies would reduce the number of wasted votes. A single transferable vote would provide fair competition to the existing duopoly in single-member constituencies. For different reasons both Aristotle and Machiavelli recommended mixed constitutions with counterbalancing virtues from different ideal types of constitution. Shouldn't our search for democracy also be directed to synthesis rather than forcing us to choose the "least bad" of extremes?

London JAKOB LUND

SIR—It is unrealistic to believe that in British elections people vote solely for the character that stands in their own constituency; they vote also for the party that backs him. Sir Karl states that a candidate has a choice of whether or not to accept party backing. If this is true then why has the Independent member been obsolete for 150 years? Without party support a candi-

date has no genuine chance of being elected. And within parliament itself the power of the party is such that voting along constituency-interest lines is rare and sensational.

There are certainly problems with the pure form of proportional representation, but there are more practical forms. For instance, the alternative member system would allow for a two-vote system, one vote for a local member and one for a party. Seats would be divided between the single-member constituencies and the proportionally elected candidates from party lists. This would mean that every vote counted and the concept of representation would not be lost. West Germany has operated this system since the war and it has proved both stable and effective.

Blandford,
Dorset NICHOLAS WHEELER

SIR—The great failure of all proportional systems lies in the fact that "centrist" parties (which can be tiny) have a quite disproportionately large influence in the process of coalition-building after the election (unless there is an absolute majority of votes for one party). In West Germany the smallest of the three traditional parties, the Free Democrats, often decide who governs the country because they occupy the "middle ground" and can bargain with either the left or right. In the autumn of 1982 they decided to change their coalition partner without reference to the voters (who were not asked for their opinion until the spring of 1983).

There is no such thing as a just electoral system. A possible pragmatic solution may be a majoritarian electoral system with two ballots (France) or preferential votes (Australia). The system enforces a clear choice between left and right and ensures that a government must have the support of more than 50% of the voters. The centrist voters must decide before the election whether to switch to the left or right. A small swing of voters can lead to a change in government (as happened in Australia in 1983). This, too, is not pure democracy. But we live in an imperfect world.

Konstanz,
W. Germany N. FAULHABER

Lloyd's lament

SIR—You accuse Lloyd's of refusing two Neill recommendations (May 7th). It has done no such thing. The only decision the council has made in respect of the consultative document regarding underwriting agency agreements is to circulate it as widely as possible, including a copy to every one of Lloyd's 33,000-plus "names", inviting comment before July 29th this year.

All submissions and comments received by that date will be considered by the council in its further deliberations on this matter.

MURRAY LAWRENCE
Chairman
Lloyd's of London

Third-world wars

SIR—I applaud your article highlighting the tragic carnage in the third world (March 12th). However, if one expands one's view from the 25 "large" wars that you describe to the 120-odd other wars being fought, a different perspective on the future emerges.

Wars of national identity will increase, not decrease. A "nation", a people with a homeland and an autonomous political and cultural tradition, can be distinguished from a "state," a modern political entity. Virtually all third-world states (and many first-world ones) include many nations within their boundaries; that is, they are empires. And in virtually all such states one nation oppresses the other nations—it deprives them of the freedom to control their land and natural resources. This is internal colonialism, and replaces or supplements the external colonialism of occupied territories and multinational corporations (by no means a thing of the past).

Wars of national identity are attempts by nations to regain control of their land, resources and future. The availability of effective weapons for guerrilla warfare, provided either by profit-seeking arms merchants or influence-seeking superpowers, will allow more groups, and groups of smaller size, to try to regain such control by force.

I agree that wars of ideology will probably decline. But many third-world "ideological" wars

are not really that. The nations involved see an alliance with capitalism or communism as a marriage of convenience (a way to get weapons and power) or desperation (any political system would be better than the existing one). As arms sources become more diversified and nations become more disillusioned with ideology, wars of national identity will shed their ideological veils—except in the eyes of the American and Soviet governments.

Ann Arbor,
Michigan WILLIAM CROFT

SIR—Your graphics for "The world's wars" were troubling because of the symbol you chose to represent death. Presuming to use a cross in a world that prohibits a parochialism that should be eschewed by a journal of your calibre.

Washington, DC CAROLYN LAUER

Yugoketchup

SIR—Your article on the opening of the McDonald's branch in Belgrade says that the Yugoslavs "had never heard of tomato ketchup" (April 16th). Your readers should know that all interested consumers may go to one of the Yugoslav factories of food products and buy unlimited quantities of Yugoslav tomato ketchup: for example, Argo-Droga which is in Portoroz, Slovenia.

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SOUTH ASIA

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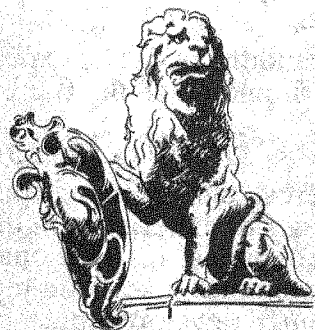
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If sterling stays parochial

FOR much of the past six weeks, British politicians have fussed over the question of sterling's exchange rate against the D-mark. This week they calmed down. Interest rates fell, and so did the pound. The spat between Margaret Thatcher and her chancellor, Nigel Lawson, seems to be over (see page 64). But it has served to enlarge a harsher question about the future of the City of London. The

city is Europe's financial capital. Along with Tokyo and New York, London runs a round-the-world, round-the-clock financial system.

Yet its dominance in Europe will slip away, probably to Frankfurt, if Britain's exchange-rate policy remains obsessively parochial and so misses out on the coming revolution in European finance.

The threat, for now, is hypothetical. But the form it could take is all too easy to imagine, because it starts from London's biggest weakness: against the American economy (GNP, \$4½ trillion) and the Japanese (\$2½ trillion), the British economy is a midget of \$700 billion. To be a centre of world finance, you need a big back yard that will give moneymen lots of local savings to tap, local bonds and equities to trade, local companies to lend to and advise.

Anybody who doubts this should recall that, at the beginning of this decade, Tokyo was not the undisputed capital of its time-zone. People knew one eastern centre would emerge, but debated the merits of several. Hongkong, Singapore and Sydney had advantages over Tokyo: lower rents and salaries, or interest rates, lower taxes, above all the English language. Yet the moment Japan's government decided it wanted the leading role for Tokyo, all argument stopped. Foreign financiers, longing to deal in the local markets of the region's biggest economy, rushed in.

London's fading charms

By the yardstick of size, London is an odd choice to be the financial capital of the European time-zone. Britain's GNP is barely half the size of West Germany's, three-quarters of France's, much the same as Italy's. So far, the City of London has overcome this disadvantage for two main reasons: (a) its rules have been more liberal than those in other European centres; and (b) it has been widely assumed that, as a member of the EEC, Britain's backyard would eventually run from the Mountains of Mourne to the Peloponnese, with 350m people and a GNP of \$4¼ trillion. Neither of these notions will hold good for much longer.

On (a), if 1992 is to be more than just another date in the calendar it will bring much freer rules to all of Europe's mar-



kets. The financial purpose of 1992 is to break down the who-does-what barriers that at the moment make it easier for foreign firms to operate in London than anywhere else in Europe. Even before the full blast of 1992 hits Frankfurt, Germany's financial institutions are changing. So is German industry. The result will be a shift in the way that companies raise money, insure themselves, finance their trade—all of it prodded by the brightest financial ideas of the Americans and Japanese as well as of other Europeans. Such changes

will affect the whole of Europe. They will be accelerated by another change that is happening already: the easing (and eventual abolition) of exchange controls, which will mean that investors and savers throughout Europe and beyond will be able to meet in one pool of money even bigger than those in Japan and the United States.

So what of (b)—that Britain, as an EEC member, would be part of this pool and thus able to ensure that much of the matching of savings and investment would take place through London? That claim becomes less plausible the longer sterling stays outside the European Monetary System. To international moneymen, the British debate over the EMS grows quainter by the day. Once it was full of real issues—the pound as an unstable petrocurrency, doubts about the EMS's own durability and effectiveness—but these have long since been settled. The one remaining obstacle to full EMS membership for sterling is Mrs Thatcher's own hostility to the idea. Her view seems to be based on bad economic history and future political fantasy.

The history comes in because previous British governments that changed sterling's exchange rate always did so by humiliating devaluations, and Mrs Thatcher wants to avoid that. In this she shows uncharacteristic modesty: the success of her own economic revolution makes it probable that any change to sterling's EMS parity would be self-confidently up, not miserably down. As for political fantasy, Mrs Thatcher fears that full EMS membership would complicate a general-election campaign if an opinion poll happened to show Labour doing well and interest rates therefore had to rise to support the pound. She overlooks the fact that, in the EMS's nine-year life, incumbent member governments have won twice as many elections as they have lost. They have rightly realised that the biggest threat to their electoral survival comes not from interest-rate blips every few years or so but from a longstanding failure to turn Europe into the large, open home market that the Japanese and Americans enjoy.

Hence the push to 1992, and the central role that the EMS

will play in it. In the rest of the EEC, the monetary future of Europe is being debated in terms that are barely heard or understood in Britain's offshore exile. The development of the ecu, the establishment of a European central bank, the possibility of a common currency: all are on the EMS agenda, because far-sighted Europeans understand that a single market in goods, services and people will be stunted unless there is also a single market in money.

London would be the obvious centre for that market, the obvious place to set up a Bank of Europe and to start trading in ecu bonds or whatever. But if sterling remains outside, Britain will be a eunuch at the talks on Europe's financial evolution, and London will become a less convenient place to do Europe's business in. Then London's basic flaw—its lack of a large economic hinterland—will be harder to disguise. Frankfurt's merits—home to the Bundesbank, engine-room of Eu-

rope's savings and industry—will become ever more obvious.

Britain has long had cause to be proud of the City of London. Throughout the country's decline from great power to the ranks of the second division, the City was a symbol that Britons hadn't lost all their international edge. Though politicians of every party have found it a convenient scapegoat, they have privately been grateful for its money-raising powers. Even so, City folk have worried that the City's role would be weakened by high taxes and intrusive rules.

Today, the biggest threat to the City comes from a tax-cutting, free-market Tory—but one whose nationalism has blinded her to the way that Europe's financial system is moving. On many issues, Mrs Thatcher has avoided the mistakes of her predecessors. On the EMS, she is repeating a bad old British habit: fighting yesterday's battles, while tomorrow's chances slip away.

Men may come and men may go

But Democratic control of America's House of Representatives goes on for ever

REPUBLICANS lost control of the House of Representatives in 1954. They have tried, and failed, to regain it every two years since. This year they will fail again. The Founding Fathers, who intended the House to be more responsive to the popular will than any other part of America's government, would be despondent. Two hundred years on, it has fallen under a party hegemony whose duration is rivalled hardly anywhere outside the communist world.

The pundits disagree about the number of seats in the 435-member House that may change hands this year. One recent report says that a contest of sorts can be found in 96 districts; others reckon no more than 50. Even in most of these the outcome is pretty clear. There is real uncertainty in only 15 or 16 races. Since the Democrats have a majority of 76 (254 seats to the Republicans' 178, with three vacant), the prospects for a change of control are about as great as they are in Volgograd city council.

Being in the majority, the Democrats are the main beneficiaries. But some Republicans also gain, for the petrification of the House reflects above all the power of incumbents to hold on to their seats. In recent elections about 90% of those who chose to run again were successful. Last time the figure was 98%. So doubt about the outcome is all but confined to the contests in which the incumbent is not seeking re-election, of which there are fewer than two dozen this year.

Does this make a mockery of the Founding Fathers' intentions, indeed of democracy? Perhaps less than it appears. Congressmen, after all, are not like most members of European parliaments. They are independent beings, often scornful of their party and its leaders, even presidents, and reluctant to be whipped through lobbies. "Democratic control" is therefore far less absolute than "Tory control" or "Social Democratic control". Yet party cohesion is increasing again after years of decline (in more than 60% of votes in the House last year, a majority of Democrats voted against a majority of

Republicans), and the great fault-line in the Democratic party, between southerners and northerners, is gone for good. Even if party loyalty were in decline, Democrats of one stripe or another would still permanently preside over the division of spoils, particularly the chairmanships of committees and subcommittees, to which so much power has flowed.

The tyranny of the incumbents

The real disgrace, however, is the fact that incumbents have entrenched themselves in power by seeing to it that challengers, never mind of which party, are put at a disadvantage whenever possible. First, congressmen have voted themselves the means to win re-election. They bombard their constituents with nearly 1 billion pieces of mail a year, all paid for by the taxpayer; in 1954 they sent out only 40m. They are each entitled to \$500,000 a year to pay a staff of 22 (up to 70 or for senators), many of whom may spend their time devilling in their boss's district, sucking up to constituents and identifying issues, through polls or other means, on which the incumbent can take an expedient line.

Second, congressmen have grown adept at the age-old art of pork-barrel politics. Politicians have been "delivering" for as long as America has had elections, certainly since the lighthouse bills of the early days of the republic. But not until the 1960s did specific grants-in-aid explode in number and did congressmen appreciate their value in winning re-election. Now almost every bill, whether nominally about trade or appropriations, is festooned with unrelated provisions, giving money for endive research in district A, extending a patent for a drug company in district B, paying for an "intermodal urban demonstration project" (road) in district C.

Third, Congress has, in the name of honest government, passed laws that enable incumbents to raise vast campaign funds which their challengers cannot hope to match. The average House race now costs \$300,000, nearly half of which



comes not from individuals or the party but from political action committees. Individuals are forbidden to give more than \$1,000 to one candidate. The committees can give \$5,000. And the committees usually prefer the pliable devil they know, the incumbent, to the devil they don't. The incumbents up for re-election this year have already raised over \$75m, compared with their challengers' \$10m.

To expect congressmen to repeal the laws that keep them in power is to expect God to repeal the laws of nature. Ask rather that the Supreme Court should step in. For the Democrats' grip on Congress is further strengthened by their con-

trol of most state legislatures, many of which shamelessly gerrymander constituency boundaries to benefit incumbents. A Supreme Court decision to end this practice could give the Republicans a fairer share of the seats (one that better reflected their vote) and increase the number of marginal seats that would change hands with modest shifts of opinion.

Shifts of opinion are, of course, reflected in Congress, but only really by the incumbents trimming their sails. In a representative body, that is not good enough. From time to time a change of party control is needed. An end to gerrymandering would not guarantee that, but it would make it less unlikely.

The road down Subsidy Mountain

Start at the Toronto summit, then take the GATT round until you reach Cheapfood Farm

HREE June days locked up in the Metro Toronto Convention Centre are likely to leave the leaders of the world's seven largest capitalist countries bored and bad tempered. Even by past standards this annual summit will have precious little on the agenda. Yet each leader has a common and cussed problem that needs to be tackled at home: what to do about costly farm policies? A patchwork of subsidies, tariff walls and price guarantees is straining every nation's treasury, making a nonsense of world trade and still not providing a decent living for many farmers. Farm reform should be made the main stuff of the summit.

A few years ago, only economists thought the industrial world could treat itself to a free lunch by reforming its farm-support policies. They said that subsidies carry such massive costs—some of them on government budgets, most of them not—that abolishing them would create the resources to compensate farmers generously and still leave everybody else better off. Politicians long viewed this as economic sense but political suicide, so let their domestic farmers' lobbies set the limits of what they dared to propose. Since 1986 they have begun to change their minds. A new round of trade talks has farm subsidies on its agenda for the first time in three decades. The American government, the most important participant in the talks, has swung decisively towards reform. The old paralysis is wearing off.

Yet farm-trade talks have got nowhere in the past three months. That is partly because the European Community is worn out after a Herculean farm-budget fight in February, and partly because rising world prices of food have temporarily eased the horrendous cost of subsidies. Neither of these is a good reason for delay, but the negotiators' sense of urgency has slipped. Untended, the present inefficiencies are certain to get worse: demand for food in rich countries is stagnant, supply is growing at 1½% a year and, with a little promised genetic engineering, could grow much faster.

What should be the aim of the farm-trade talks? America's answer is blunt: to abolish within a decade all farm subsidies which distort production. Countries could still keep their farmers off the breadline and their scenery pretty, but food trade and prices would be determined by the market, a long-

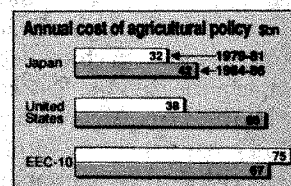
lost friend. Europe's reply is mealy-mouthed. It wants to reduce farm subsidies, not eliminate them; and it hates deadlines. If Europe's politicians cared about the inflated prices their consumers have to pay, the implicit taxes levied on industry, the harm their policies do to poor countries, they would accept full liberalisation as the goal. Instead, they worry mostly about their farm budget.

The cost to the consumer appears in no public accounts. If it did there would be an outcry. Shoppers in Europe meet 62% of the cost of farm support in higher prices. The Japanese, who have the worst of all farm policies, make their consumers pay 75% of the cost through the most inflated food prices in the world; added to this is the cost of justified American annoyance at being denied free access to their market. The Toronto meeting provides the opportunity for Mr Noboru Takeshita and the European leaders to give the farm-trade talks a push by agreeing on a common goal: an end to all trade-distorting subsidies. This is the broad-brush policy-making that economic summits are for; the GATT talks could then grind slowly through the details.

Impatience is a virtue

Such an agreement on ultimate ends between America, Japan and Europe would brighten the outlook for the mid-term review of the trade round, which takes place in December. If there could be an agreement on means too, even better. Europe and America should consider a proposal made by the recently retired head of Britain's agricultural ministry: to halve farm support over five years, giving each country the power to decide where to cut. The summiteers should also agree to submit lists of their trade-distorting farm policies to the GATT secretariat, for costing and regular scrutiny.

Above all, the partners must regain their sense of urgency. "Realists" point out that in 25 years the main industrial countries reduced tariffs on industrial goods only from 15.6% to 6.3%. That was not good enough for trade in manufactures, and it is not good enough for agricultural trade. At last governments are daring to talk about real reform. That was the hard part. Now they should get on with it.



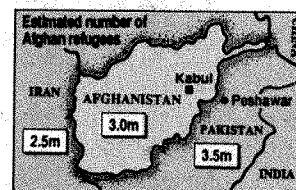
Homeward bound

It's no good just shifting Afghans from one refugee camp to another

AFGHANS have won the war, but what about the peace? Now that Russia's troops are marching home, the Afghans could find that rebuilding their country is even tougher than clobbering a superpower. It will require the resettlement of up to 9m people, the largest migration since the partition of India in 1947. Afghanistan will need a lot of help; and the wrong sort of help could deepen the country's divisions and complete the ruin the Russians began.

Nearly 3½m Afghans have fled to Pakistan, and 2½m to Iran. Perhaps 3m more within Afghanistan itself have moved to the cities or the mountains in the hope of finding safety. When the fighting ends, most of them will want to go back to their homes. If they go back in one wave, they could cause a disaster. Some refugees, given food, building materials and seed, may be able to support themselves after a single harvest. Others will take far longer. Afghanistan has lost half its livestock. Many of the irrigation channels, a system developed over centuries, have been bombed into ruin or have silted up for lack of maintenance. Devastated orchards, like those for which Kandahar was once famous, will take years to replace. The countryside is littered with mines.

If refugees pour back before it is possible for them to resume their old lives, new camps will have to be built in Afghanistan, to replace the ones they leave behind in Pakistan. Political manipulation would follow the refugees into these new camps. All the people contending for power when the Russians are gone—the Moscow-backed government, the formerly Pakistan-based leaders of the resistance, the guerrilla commanders in the field—would try to control the new camps, by the distribution of aid, perhaps even by force. In Pakistan, where refugees have to hold a party card to get rations, aid is often used for factional leverage. In Afghanistan the aid-distributors would have an incentive to keep people in



the camps, instead of dispersing them to take up normal life again when something like normal life becomes possible.

There is a better way. A handful of the 80-odd voluntary aid organisations based in Pakistan run cross-border aid schemes. They deal directly with guerrilla commanders and other local notables inside Afghanistan, who ask for money for specific projects, such as building a well. The most deserving projects get the money, with the expectation of more if they are a success. The local people know all about it. This reduces corruption. The system suits the variety of Afghanistan, where every valley has its own troubles and every tribe its own customs. It is cheap to administer. It is also more efficient, because it is run through the existing power structure instead of being used to build a new one.

Wait for the canals

This grass-roots distribution system has worked well for budgets of a few million dollars a year; but it is time-consuming. Would expanding it take too long, and could it cope with the hundreds of millions of dollars that Afghanistan is going to need? Give it a chance. Its workability has been proved. It will help to rebuild the infrastructure without which the economy cannot absorb the returning refugees. It is relatively non-inflationary. This is where the aid should go first, and it should go there now. The cross-border aid organisations are turning down suitable projects for lack of cash.

Prince Sadruddin Aga Khan, the newly appointed United Nations co-ordinator of aid for Afghanistan, is talking of setting up "reception centres" in the country to take people returning from abroad. Pakistan's understandable desire to get rid of the refugees may make some such camps necessary in the end. But not too many, or too soon. Afghanistan can't be rebuilt no faster than its irrigation channels.

Syria has to choose

President Assad's support for Iran, and Iran's proxy gunmen in Lebanon, is damaging his bigger interests

"THE Assyrian came down like a wolf on the fold." Well, that is what he said he would do. By Thursday morning, however, the Syrian army's much-heralded push into the southern suburbs of Beirut had yet to happen. It was the Syrian soldiers who were looking sheepish, not Lebanon's Shia fundamentalists, whom Syria had promised to subdue.

Syria's President Hafez Assad is a wary man, a quality that has until now served him well in Lebanon. He recognised long before Israel did the folly of using military means alone to stamp his power into the Lebanese quicksand. As a result, the



Syrian expeditionary force in Lebanon rarely does battle when Syria's local allies can be persuaded to do Mr Assad's fighting for him. It was Lebanese fighting men—Shia Muslims of the Amal militia—who spent much of 1986 trying to impose Syria's will on Lebanon's Palestinian refugee camps.

It would suit Syria nicely if Amal could now bring order to the southern part of Beirut. Those dismal neighbourhoods have been transformed into a miniature Islamic republic, fortified and defended by several thousand members of Hezbollah, the Lebanese "Party of God" that draws its arms,

inspiration and treasure from Ayatollah Khomeini's Iran.

Alas, Amal is not up to the job. In April its militiamen pushed Hezbollah out of many of its strongholds in southern Lebanon, from where Hezbollah had threatened to drag Israel and Syria into an unwanted war. But Amal's attempt to beat Hezbollah in Beirut has been a disaster. Hezbollah has enlarged its Beirut holdings and defied Syria's demands to give up its newly captured positions. Only Ayatollah Khomeini, the Hezbollah fighters say, can tell them what to do.

What you do when remote control doesn't work

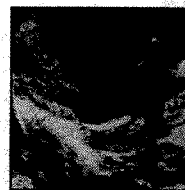
If your power is built on a wolf-like reputation, you must sometimes devour a lamb—even if, like Hezbollah, it is a lamb with a powerful kick. Over the past few days, and amid much bluster, Mr Assad has assembled enough men and tanks in Beirut for his army to overrun Hezbollah's stronghold in the southern suburbs. If he now shrinks from using them, or from forcing Hezbollah to submit without a fight, his power in Lebanon and further afield will diminish.

Two things seem to be making him pause. One is the certainty that storming the southern suburbs against Hezbollah's resistance would entail bloodshed on a scale that even battle-calloused Beirut would shudder at. On past form, this consideration on its own is unlikely to deter Mr Assad for long. In 1982 his army killed many thousands of civilians in Syria's own mutinous city of Hama, and Mr Assad got away with it. Most Lebanese Christians, and many Lebanese Muslims who fear the growth of Iranian power in Lebanon, would applaud Hezbollah's destruction at almost any price.

Mr Assad's bigger worry is that his alliance with Iran might not survive a Syrian war against Iran's supporters in Lebanon. This alliance matters to Syria. It brings Syria cheap Iranian oil and gives Syrian views special weight in inter-Arab counsels. Above all, it undermines Mr Assad's main Arab rival, President Saddam Hussein of Iraq. Iran has done badly in the Gulf war lately: it will not lightly break with its only Arab friend. But Iran also cares about Hezbollah. Outside Iran itself, the southern suburbs of Beirut are the only corner of the world to have embraced the spiritual leadership of Ayatollah Khomeini. Hezbollah has done Iran stout service, not least by providing a regular supply of western hostages to be traded for western favours. Iran and Syria would prefer a peaceful compromise in Beirut.

Amen. But, for Mr Assad's own calculations, it has to be a compromise that entails some public humbling of Hezbollah. A return by Hezbollah to its former lines, and the release of its western hostages, would be enough. Mr Assad's alliance with Iran is convenient but not essential. The battle for southern Beirut, by contrast, is not just another Lebanese tiff. A century and a half ago, the Druzes of Lebanon lost their primacy to the Maronite Christians. Today it is the Shias who are moving inexorably towards ascendancy. Anything less than a clear Syrian success in south Beirut will register as a Hezbollah victory. That could make southern Beirut into an even stronger outpost for Iran's revolution, and hand the leadership of Lebanon's Shias to the most violent and least compromising men in that revolution. The Assyrian should pounce now, if he is ever to pounce at all.

Fields into houses



How to build in south-east England without upsetting the nimbies

THREATEN to run up a housing estate in the back yard of an ardent free-marketeer, and you will uncover a recent convert to the virtue of tight state planning. Britain's environment secretary, Mr Nicholas Ridley, has increased by a third, to 610,000, his department's forecast of the number of new households needing accommodation in south-east England by the turn of the century. As a result, over 90 Tory backbenchers, including some keen Thatcherites, have joined a parliamentary group dedicated to Sane Planning: double-speak for "not-in-my-back-yard", or nimbysm. Some shire Tories reckon that property development will cause more trouble in their ranks at Westminster than anything else, and wonder why the Labour party has not latched on to it. One way to avoid trouble is for developers to make more effort to woo the people in whose back yards they want to build.

For more houses will undoubtedly be needed—even if Mr Ridley's new forecast proves to be no more reliable than the previous one. The pressure on the housing market in the south-east is clear from the stronger rise in prices in that region (see page 65) than elsewhere in Britain. It comes, not mainly from new arrivals in the south-east, but from the increasing number of households: the products of social

changes such as divorce and an aging population.

Those agitating for development are wrong to argue that more housebuilding in the rural south-east is the only possible answer to this rise in demand. Higher house prices there are one way to encourage people and businesses to move northwards. Indeed, an acceleration of price rises outside the south-east suggests that this may be beginning already. It could go further if more civil servants were prised out of cosy central-London offices. But the conservationists overstate the merits of a regional policy based largely on stopping south-east housebuilding. If existing owners' houses can be sold for £200,000, because planners stop similar houses from being built much more cheaply, planners are distorting local economics in a way that does most to hit poor people and increase homelessness.

There are other less damaging ways in which ministers could reduce pressure on the south-east. Their present tax policies have fostered demand. Absurdly generous tax advantages for owner-occupiers have pushed home-ownership in the south-east outside London up to 70%—the highest rate in Europe—and encouraged lavish under-occupation. The abolition of rates, the last tax on property, will remove one of

the strongest incentives for little old widows to sell their family home and move into something smaller.

More houses and flats could be built in existing towns. The developers say they must build where people prefer to live, which is in the south-eastern countryside. Yet in the past two years over half the new housebuilding in the south-east has been on underused urban land, and none of it has proved hard to sell. More derelict land in southern cities could be brought into use through a vigorous urban programme, though not enough to build homes for all who want them.

Welcome to my back yard

Come what may, some new houses must be built in the south-eastern countryside over the next decade. Opposition to them will foment more easily if myths about the government's intentions are allowed to take root. One myth is that the developers are about to concrete over the "green belts" around big towns that now cover a fifth of the English countryside. Ministers have shown repeatedly that they will reject any such proposals. Central government does not often overrule local authorities: 98% of planning consents are given locally, not

on appeal; and of those proposals (admittedly the biggest) that do go to appeal, 60% are still turned down.

New housing ought often to be clustered in new towns of, say, 4,000-5,000 houses. That is preferable to the alternative of ruining hundreds of existing villages with new 50-house estates. More new sites for such towns should be found to the east of London. Parts of Kent and Essex could accommodate—and might even welcome—more building. Their flat landscapes are less easily scarred by unsympathetic housing than the open hills west of London.

Planners and developers should pay more attention to variation of architectural style, sympathetic building materials and landscaping, even if this means a slight increase in cost. Nobody likes serried ranks of identical houses. They do like trees, swimming pools, tennis courts, so developers should spend more on amenities that will make a new town a welcome addition to an area. They might even contribute to the cost of new bypasses. Nimbyism, a selfish emotion, is best overcome by an appeal to selfishness of a different sort. Adam Smith understood that 200 years ago, and he is supposed to have some followers in today's Tory party.

Emergency ward

For the world's sake, do something about AIDS in Africa

AFRICA's known plagues include war, hunger, debt, disunity. Beside them, to some African eyes, the unmeasured threat of AIDS looms small. The official figures minimise the danger, with a world total so far of 70,000 reported cases, of which 50,000 are supposed to be in the United States. The official figures are rubbish. The truth is obscured by governmental complacency, anecdotal panic and a scientific void.

In areas like Africa, nobody knows the size of the danger. Zaire, Uganda, Rwanda, Congo and their neighbours have no effective medical services, no testing laboratories, no statisticians. Relatively rich Nigeria records ten deaths from AIDS—but only 25,000 of its 100m people have ever been tested for the virus that causes the disease. Reputable doctors think AIDS may be commoner in Africa than in its world capital of San Francisco. In rich countries it has spread by buggery and filthy needles, in Africa (it seems) by heterosexual contact like any venereal disease. That would endanger whole populations: men, women and new-born children.

Even the fear, let alone the reality, of such an epidemic will have awful effects. In black Africa's most sophisticated country, Zimbabwe, AIDS recently killed a British doctor who unwittingly contracted it from an undiagnosed patient's blood. Africa in its complex of crises desperately needs travellers from outside: doctors, technical consultants, World Bank missionaries, private investors, above all the return of its own students after being educated abroad. The continent cannot even start to recover from all its other disasters if such people stay away, frightened for themselves and for their families.

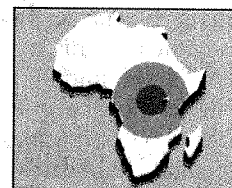
Although donors are weary of offering Africa more of the aid that has so often been wasted, the case for special research

into AIDS is self-interested as well as humanitarian. Finding out the truth might prevent the establishment of a great world reservoir of the new plague. But help goes to those who ask, and most African governments are reluctant even to admit that they have the scourge, let alone seek assistance to tackle it. Mr Kenneth Kaunda of Zambia, this year's chairman of the Organisation of African Unity, has honourably admitted that his son died of it, and that his country needs help to fight it. Many other leaders, notably those of Kenya (especially endangered because of its many tourists), seem to be trying to fight AIDS by banning talk of it.

Ignorance kills

Some African rulers prefer ignorance to the possibly terrifying truth. None wants to take implicit blame for a disease mainly transmitted by sex. A few argue that other diseases—malaria, measles, bilharzia, hepatitis, sleeping sickness—kill tens of thousands of their people, and could be relatively cheaply cured, while AIDS has hardly begun killing people yet, and cannot be cured at all. Why devote desperately scarce resources to an insoluble problem, when soluble ones wait to be confronted?

This sounds logical, but isn't. Africa's established, appalling sicknesses would look almost benign if AIDS really took root. The first, absolute need is to identify and define the danger, the mere suspicion of which is already frightening off the helpers the continent most needs. Africans have to open their minds, and Africa's friends abroad their purses, if they are to confront this potential menace to all mankind.



THE RHINE AND THE OHIO

A tale of two rivers

The decline of their heavy industries left towns along the Ohio and the Rhine up river without a paddle. The Americans have created new jobs for old more quickly; the Europeans have changed old industrial slums into civilised places to live and work. Both have lessons to teach—and to learn

THE raw material of today's growth industries is a weightless "information" transported instantaneously through the ether. Aircraft have shrunk the world; the conditioner has shoved savage climates out of doors. A decision to locate a new factory or office in one place or another—indeed, to develop a whole industry from scratch—is less bounded than ever before by climate or geography. Some of today's booming areas in Europe and America were once deserts (the south-western American states, northern Mexico) or backward, farming regions (Provence, Bavaria, East Anglia). Rivers, once a necessity for inland economic development, are now an optional extra.

The biggest losers are the river systems of the Rhine and the Ohio, homes to the foundries and factories of the industrial revolution. The Rhine is 820 miles long, flowing from Swiss valleys above Lake Constance to the North Sea below Rotterdam. The Ohio flows 980 miles from Pittsburgh, where it is formed by the junction of the Monongahela and Allegheny rivers, westwards to the Mississippi, which it meets between St Louis and Memphis. Both are navigable for much of their length. Duisburg, on the Rhine, calls itself the world's largest river port, and handles about 18m tonnes of goods a year; Cincinnati, on the Ohio, shifts around 16m tonnes. The basins of both rivers are among the most densely populated regions on their continents.

As commercial centres, the Rhine cities are far older than their American counterparts. Cologne was a sizeable Roman town; Louisville, Cincinnati and Pittsburgh were all founded in the second half of the eighteenth century. But as industrial centres, in the strict sense, the American towns are no more "modern" than the ones in Europe.

Pittsburgh was first called "the Birmingham of America" in 1821; the coal reserves of the Ruhr, which flows into the Rhine at Duisburg, were not developed until 1838. Only four years later James Silk Buckingham, a British member of Parliament from Sheffield, found that his home town's atmo-

sphere was "clear and translucent compared with Pittsburgh, which is certainly the most smoky and sooty town it has ever been my lot to behold."

The long goodbye

The Ohio basin has more land given over to farming than the Rhine. Overwhelmingly, however, the economy of the two regions is industrial. Both have one area (Pittsburgh and the Ruhr) that committed itself to coal and metalworking. The largest employers in Louisville are General Electric and Ford. Cincinnati's largest plants are owned by GE, again, and Procter & Gamble, a soap-to-food giant. Pittsburgh has been synonymous with steel, glass and aluminium. In the Rhine basin are the headquarters of many of West Germany's blue-chip industrial companies, such as Krupp in Essen, Mannesmann in Düsseldorf, and Thyssen in Duisburg; and two chemical companies, Bayer in Leverkusen and BASF in Ludwigshafen. Up river in Basle, where the Rhine makes a huge turn to the east, are the three Swiss chemical giants: Sandoz, Ciba-Geigy

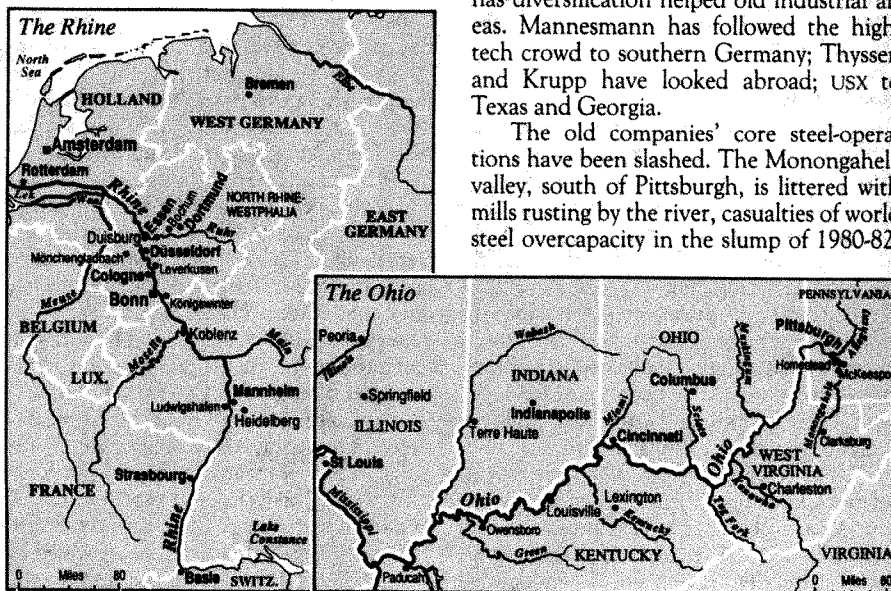
and Hoffmann-La Roche.

The exhaustion of cheap natural resources and competition from newly-industrialising regions as well as countries have combined to force both the Rhine and the Ohio to restructure their economies. This is seen most dramatically in North Rhine-Westphalia, the German land that has the greatest concentration of old industry. It accounted for 42% of West Germany's GDP in 1950 but only 29% by 1986. This is not simply a matter of other places catching up; the land's own output (at constant prices) is below its 1973 level.

Old timers in both river basins yearn for the boom days of the 1950s, the years of post-war recovery for West Germany and of unchallenged industrial pre-eminence for America. Pittsburgh was cocky enough to launch a "Renaissance" designed to clean up the city, build a shiny new centre, and control endemic floods. Ruhr coal started to contract in the 1950s (when it employed more than 400,000 men, nearly four times as many as today). Later came the job-saving mechanisation of industrial plants: GE slashed its Louisville workforce; Pittsburgh shed more than 130,000 manufacturing jobs between 1965 and 1985.

Many of the biggest regional companies on both rivers have diversified to reduce their dependence on their traditional operations. Only a little over a third of Thyssen's sales are of unfinished steel; Mannesmann, the great maker of steel tubes, is now in electronics and hydraulics; United States Steel bought Marathon Oil, decided that the steel business did not fit its image, and changed its name to USX. In none of these companies has diversification helped old industrial areas. Mannesmann has followed the high-tech crowd to southern Germany; Thyssen and Krupp have looked abroad; USX to Texas and Georgia.

The old companies' core steel-operations have been slashed. The Monongahela valley, south of Pittsburgh, is littered with mills rusting by the river, casualties of world steel overcapacity in the slump of 1980-82.



THE RHINE AND THE OHIO

North Rhine-Westphalia confronts the same problem. Employment in iron and steel in the Ruhr has just about halved (to 88,000) since 1961, and looks set to decline further. In bitter demonstrations earlier this year over the threatened closure of the Krupp plant at Rheinhausen, steelworkers blocked roads and bridges, and burst in on a board of directors' meeting at Essen's Villa Hugel, home of the Krupp dynasty and the inner sanctum of German heavy industry.

Unemployment in the Ruhr is above 16%. America's greater success in creating new jobs has kept regional unemployment lower in the Ohio valley—though in some depressed pockets, rates are as high as along the Rhine. Many people have left to find work elsewhere. Louisville's population fell by 17% between 1970 and 1980; the Ruhr

hand out cards that have their names in both English and Japanese. Düsseldorf rejoices in its reputation as Japan's favourite German city.

Many mainstream economists in America are sceptical about such boosterism. They think most companies favour a stable business climate over such inducements as capital-expenditure grants and tax holidays. Too much emphasis is put on inward investment anyway. The economic developers at the Campaign for Greater Louisville have little doubt about where their priorities should lie. Up to four-fifths of new jobs in their city, they say, will come from companies already there.

Luring new firms, or persuading old ones to grow, is made harder by a history of labour problems. In America a "river city"

pressive effort has been made to remove the detritus of industrial decay. The Ohio valley is pockmarked by industrial slums but, Pittsburgh now has a thriving downtown. Cincinnati, a quiet, conservative place (*Penthouse* and *Playboy* are hidden from view at its airport's news stands) is one of America's nicest cities.

America picks its brains

Apart from improving labour relations and singing the praises of the hometown, how else is economic regeneration achieved? All agree that most new jobs are going to come in services. So Cologne is planning to build a "media park", full of television companies and satellite links, just north of its city centre; Louisville was thrilled when it beat other cities for the headquarters of America's Presbyterian church.

In services, American cities have one great advantage that their counterparts in Europe are denied. They can establish themselves as regional centres in a single, continent-wide economy. Louisville airport, for example, was chosen by UPS, a leading express-parcel delivery company, as the main base of its country-wide operations. Of even greater importance, American cities have spotted much more quickly the need for synergy between their businesses and their universities. This is especially obvious in healthcare, which both Louisville and Pittsburgh have identified as a growth industry that depends for its success on tapping into high-quality research and researchers.

Since they first lost jobs, many American towns along the Ohio have come to believe that they need good universities to help win them back. Leading citizens of Louisville and Cincinnati complain (privately) that their universities are not up to scratch. Pittsburgh's efforts to turn itself into a high-technology centre depend heavily on Carnegie-Mellon and Pittsburgh universities, its two world-class research institutions. P, the largest employer outside government the city, is developing the 85-acre site of Gulf Oil's research laboratories (which left the city when Gulf was bought by Chevron) into an applied-research centre. The two universities are now as much a part of the corporate climate of the city as the Mellon Bank, USX, Alcoa or PPG.

All the hyperbole apart, the claim that universities are a key to industrial regeneration remains empirically unproven. But it is certainly now believed in West Germany, where businessmen grumble that the old university towns, like Heidelberg and Bonn, have failed to meet their needs, and look with envy at university-industry links everywhere from North Carolina to Scotland. The Ruhr, Germany's most densely populated region, did not have a university at all until one was founded in Bochum in the early 1960s, to be quickly followed by four others. In 1965 only about 6% of North



America's smokebelt

has lost 500,000 people since 1965. But the areas remain densely populated, and their common challenge is to find new jobs to replace those that have gone.

Boosterism

On both rivers a bewildering number of public, private, state, local and national agencies, boards and committees bend their arms to the task of economic regeneration. The growth industry of the 1980s, beyond all others, seems to be something called "economic development".

The most obvious way to get new jobs is inward investment. Cologne's chamber of commerce has a section dedicated to wooing foreign companies. The Economic Development Corporation for North Rhine-Westphalia boasts that it "substantially contributed" to Toshiba's decision to set up a video-recorder plant in Mönchengladbach. Cincinnati's chamber of commerce has a three-volume package extolling the city's charms. In Kentucky local businessmen

is almost synonymous with high levels of union membership. Louisville's labour relations once led employers to call it Lousyville. Bosses and workers in Pittsburgh's steel industry rub along better than they used to, but punishing strikes still occur in the coalfields of Kentucky and West Virginia. In West Germany the latest demonstrations in the Ruhr have vexed businessmen.

Both river areas also have a reputation for a low quality of life—a reputation entrenched by industrial accidents. Last year a fire at Sandoz in Basle was followed by the discharge of toxic chemicals into the river. This year a huge diesel tank split and spilt fuel into the Allegheny, polluting the drinking water of many Pennsylvanians.

Publicists for the Ohio and Rhine basins complain that these images are grossly unfair. The Europeans can say it with more conviction. The Ruhr is far more than a collection of smokestacks permanently circled by racing-pigeons. Its towns are separated by some delightful open country, and an im-

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THE RHINE AND THE OHIO

Rhine-Westphalia's students came from the Ruhr; today more than 27% do.

The extraordinary degree of partnership between large companies and city and local governments in America is another advantage that the Rhine lacks. In Cincinnati, a city that prides itself on its sense of community, Procter & Gamble willingly takes on responsibilities that elsewhere would belong entirely to government. In 1986, for example, the city's mayor asked Mr John Smale, Procter & Gamble's chief executive, to head a commission of businessmen charged with examining the state of the city's infrastructure. The commission reported in favour of increasing the city's tax on incomes and corporate profits.

Pittsburgh is the American city that has taken the business-government partnership most to heart. The Allegheny Conference on Community Development, founded in 1943, is a club of local chief executives that has played a central role in rebuilding downtown. Like an amoeba, it has spent 45 years redividing. In 1955 it spun off the Regional Economic Development Corporation, just as Pittsburgh first lost jobs; that in turn led, in 1972, to the Penn's Southwest Association, to market the charms of the region. Now the association has itself spawned the Pittsburgh High Technology Centre to sell the new, clean city.

All these bodies, working closely with city and state governments, represent the commitment of thousands of hours of executives' time, and lots of their companies' money. Despite the statutory responsibility that West German chambers of commerce have for the organisation of vocational training, there is no European equivalent of the scale of this corporate involvement in economic regeneration.

With big advantages in high-technology, stronger industry-university links and a partnership between the government and business far in advance of Europe, American cities have some powerful advantages. Yet the troubling, unquantifiable, but unavoidable fact is that they are in many ways less prosperous and less appealing than their European counterparts.

Civilised Europe

You will search in vain for a German city as down-at-heel as Louisville; along the Rhine you will find no slums like those of Pittsburgh; no lost, small towns, like those in Kentucky and Ohio. The division between wealth and poverty, so evident in America, has no analogue in West Germany or Switzerland. The very buildings—the bricks and mortar of capitalism—are different. The triumphalism of Pittsburgh's skyscrapers—a horrible glass version of the House of Lords' tower, a "cathedral of learning" that looks like a Gothic church after a course of growth hormones—has no European equivalents. The offices of Thyssen, Krupp and

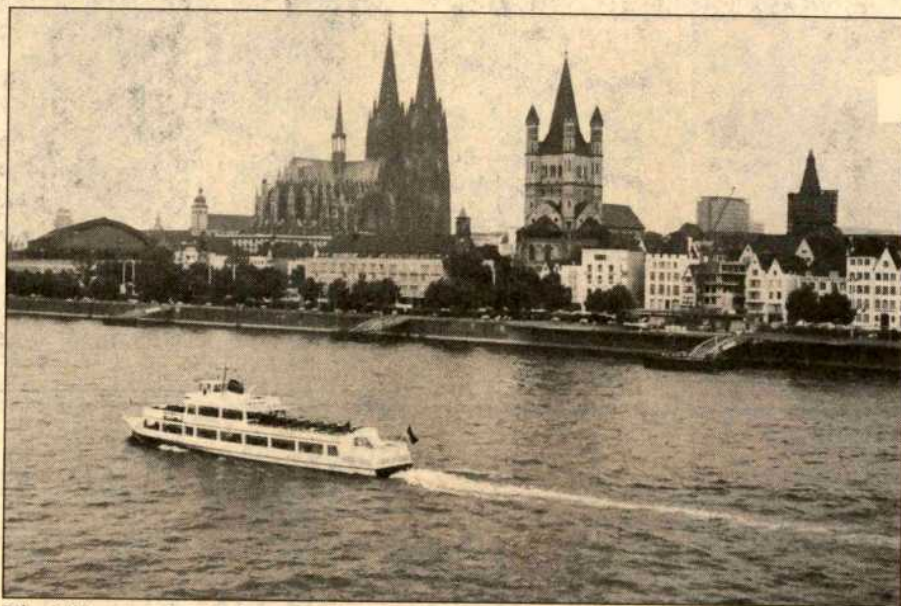
Mannesmann are, by comparison, quiet to the point of timidity.

Moreover, despite the troubles at Rheinhausen, and the obvious pain of economic adjustment, there is no European equivalent of the sheer hopelessness of the towns along the Monongahela, each with its rusting, rotting steel mill. Homestead, once an important steel town, is reduced to announcing at its city-limits that it is the "Odour control capital of the world". Perhaps it is. A few miles away, in a devastated section of McKeesport, the men at the unemployed workers' committee, when asked how they feel about the new, bright, image of Pittsburgh, say simply: "We feel left out".

Even right-wing governments in Europe are unwilling to leave such communities entirely to the play of market forces. At a con-

was rampant when Beazer's, an English building-materials firm, tried to buy Koppers, a local outfit, this year. In Cincinnati a senior figure at the chamber of commerce can boast that the city has more companies in the *Fortune 500* than "anywhere else in Ohio". Along the Rhine, companies and cities alike know that this parochialism is misplaced. The Regio Basiliensis, based in Basle, is an economic-development association that helps towns in three countries; Strasbourg is home to a polyglot bunch of Eurocrats; Cologne wants to become one of the main distribution centres in the single European market. This perception of other countries, other worlds, is increasingly going to serve Europe's towns and industries well.

America can and probably will become less parochial. It will find it less easy to emu-



The Rhine washes Cologne

ference on the Ruhr's problems in February this year, Mr Helmut Kohl, the federal chancellor, listed the interventions—a space agency here, DM500m extra investment by the post office there—that central government was prepared to make. Those parts of West Germany that use nuclear power pay the *kohlepfennig*, a special tax which acts as a subsidy to the coal miners of the Ruhr. In America, by contrast, the federal government has just about withdrawn from regional economic assistance.

Along the Ohio, the environmental efforts are local, not regional. The Ruhr has found a better way. After successfully tackling the area's industrial decay, the *land* government of North Rhine-Westphalia even has a ruse that links this clean-up to the creation of new technology. It is encouraging the growth of companies offering for sale the environmental technology developed during the cleansing operation.

European cities also have some intangible advantages. In Pittsburgh xenophobia

late the way in which the wealth of German and Swiss towns is spread around; the security, and comfort, of their mixed economies; the feeling that it is possible to fall, but fall only so far. Differences in tradition do, after all, matter. It is futile to suppose that a small town on the Ohio, somewhere between Paducah and Owensboro, is ever going to look beautiful. When its textile plant closes, its furniture maker leaves, it takes with it what has made the town tick. This is simply not the case in Europe.

Königswinter, a town across the river from Bonn, is just one of many places squashed between the river and Wagnerian hills that can convincingly say it is an agreeable place to live and work in as well as to visit. Cologne and Basle, Strasbourg and Königswinter, had a life and a purpose centuries before the first Bessemer steel furnace or petrochemical plant. In tomorrow's economy, yesterday's strengths will stand them in good stead.



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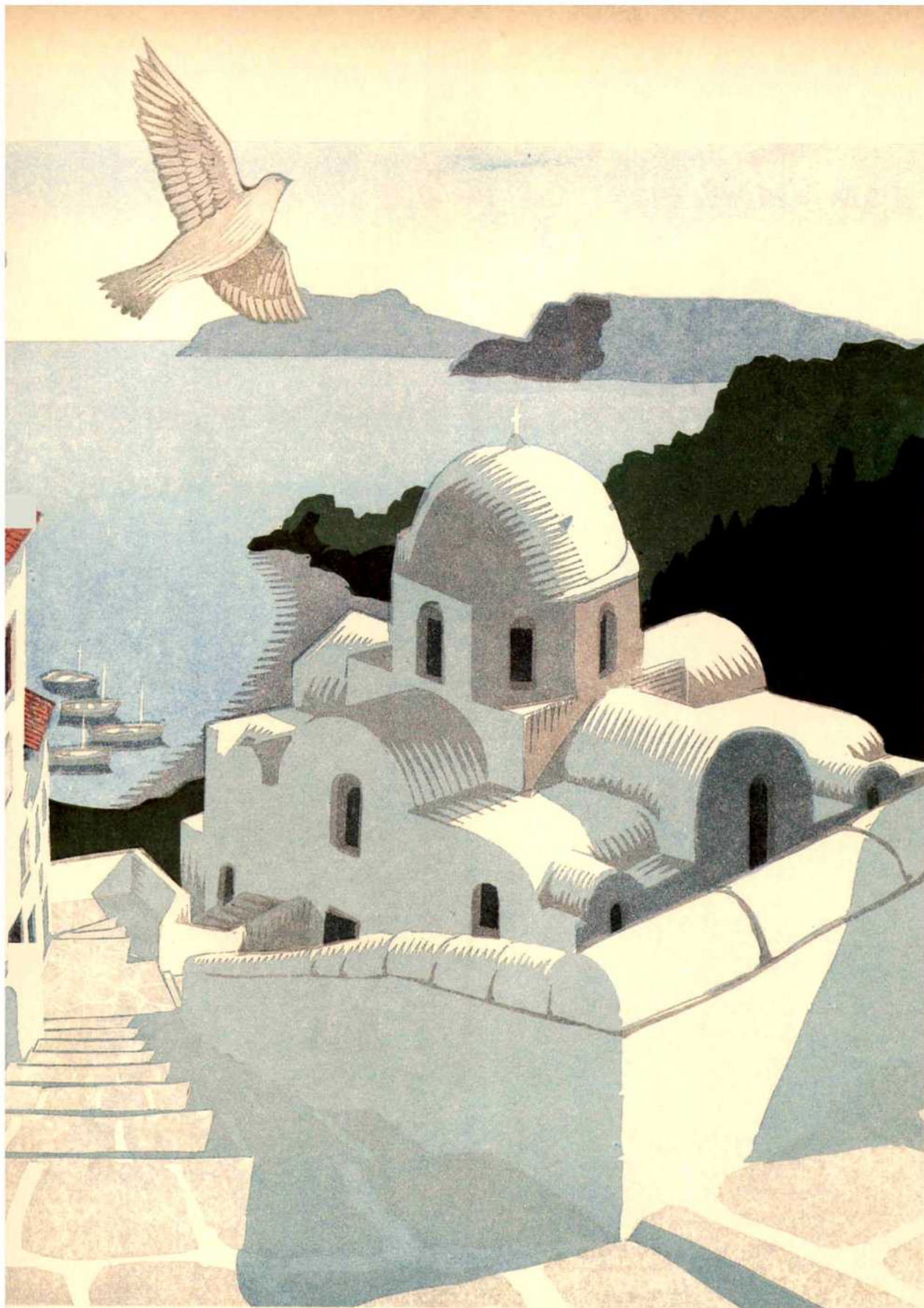
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The retreat from Kabul

NOBODY was quoting Ogden Nash: You look divine as you advance/ Have you seen yourself retreating? Yet, among the Russians, while there was hardly a spirit of levity, neither was there any outward show of gloom. They were going home. In western eyes, May 15 1988 was the extraordinary and far-from-expected day of days when the Russians started to pull out of a place their army had marched into in pursuit of its "internationalist duty". The soldiers had been looking forward to it, too.

They have experienced the classic disappointments of colonial warfare. Told by their political masters that they were answering a call from a threatened ally, they learnt instead that to most Afghans and most other Muslims, as well as to the West, they were just invaders. What was supposed to be an interesting and exotic posting turned out to be a terrifying one. So home, chaps, to Kiev and Omsk, to show your medals and catch up with the debate on *perestroika*. If there was one problem left it was how to leave Afghanistan with some dignity and, most important, with your life.

At least they had a soldierly send-off. At Jalalabad, the Russian base from which a first contingent of soldiers withdrew amid publicity, some hundreds of Afghans were persuaded to throw flowers at the column of 1,300 men travelling in 300 tanks and armoured cars as it left the town. True, there were some lumps of dung among the tributes, but no bombs. When the soldiers reached Kabul, his "dear friends" were thanked by President Najibullah: fulsomely but no doubt sincerely. They have been his communist party's guardians for the past eight years.

There were caviar sandwiches and warm champagne for the officers. Then the Russian soldiers, "our boys", as Lieutenant-General Vladimir Bogdanov calls his charges in the manner of military brass in every army, set off northwards for the Soviet border. "We'll miss you", shouted some Afghans, perhaps truthfully if they were communists: the future for them is obscure. The soldiers waved back, some of them with the bush hats which at first sight make a west-

erner blink and wonder what the Boy Scouts are doing in this place.

The 200-mile road to the Oxus river which marks the frontier with the Soviet Union is, by the standards of Afghan infrastructure, a good one. But it passes through places that might have been constructed for ambushes, including the notorious Salang Tunnel, the scene of previous guerrilla attacks. The armoured cars offer protection against snipers' bullets but, because of the summer's blistering heat, the soldiers mostly prefer to sit on top of them. Nevertheless the column made it, without casualties, to the border town of Termez, where the lads were given a tumultuous reception by their own people.

Their arrival made nice pictures for Soviet television, but the Russians are not complacent. This was the first of many journeys before the withdrawal is supposed to be



Flowers for the living

completed in nine months' time. The next retreating column, or the one after that, may not get through unscathed.

The size of the Soviet military commitment to Afghanistan—Mr Mikhail Gorbachev's "bleeding wound"—can only be guessed, because the Russians have never published any figures. The figure generally accepted in the West, and not too vigorously denied by the Russians, is around 115,000 men, maybe somewhat more, minus the 1,300 who left this week. The Russians this



week admitted to losing 15,000 dead, but the true number could be a lot more. Around 700,000 Soviet soldiers have served in Afghanistan at some time over the past eight years, so many millions of Soviet citizens have relations, or friends, with experience of the war. They have created an undercurrent of public loathing for the war which is now allowed expression in the somewhat more open Soviet press.

The Afghan debacle is sometimes called Russia's Vietnam, although this comparison is not heard in the Soviet Union: their army, say the Russians, has not been defeated. All the same, Russia's post-Afghan experience is likely to echo America's post-Vietnam one. Many young men have gone home with a drug habit. The ones who have had particularly horrible experiences find it difficult to readjust to civilian life. They will not be shot, or sent to a labour camp, like those who failed to readjust to Stalin's Russia after the second world war; but they could be a long-term problem.

Some ex-soldiers feel they are not getting enough praise for the work in Afghanistan, and have been allowed to grumble that, at Moscow's annual Victory Day celebrations on May 9th, all the attention, as always, was given to those who had beaten the Germans in the Great Patriotic War.

As America did, Russia is leaving a country where the war goes on. How will it be settled? Will Mr Najibullah's government in Kabul survive without its Russian protectors, or will, as conventional wisdom has it, the mujaheddin soon become Afghanistan's new masters?

On May 14th, the day before the Russians started to leave, the seven-party guerrilla alliance in Peshawar, Pakistan's frontier town with Afghanistan, gave reporters

copies of the constitution for the interim government the guerrillas say they will set up when they have captured Kabul. Taking Kabul may not, however, be easy.

Western diplomats in Pakistan are less confident of an early collapse of the Kabul government than they were six months ago. Mr Najibullah still has a useful armed force. The government's 50,000-strong—largely conscript—army is not impressive. But Mr Najibullah also has 50,000-odd paramilitary policemen, and up to 20,000 professionals in the military wing of the Khad, the secret police. Then there are the tribal leaders who have sided with the regime just because their local enemy has gone with the resistance.

The resistance is divided by hatreds strong enough to have made its leaders draw pistols on each other. It has never had a co-ordinated military plan, any more than it has had a unified political structure. The Afghans' assortment of tribal and ethnic loyalties makes it hard for a de Gaulle or a Mao Zedong to emerge out of the resistance. Power may grow out of the barrel of a gun, but how?

Mr Ahmad Shah Massoud, the commander who dominates the north-east, is the nearest thing to an Afghan with enough fighting prowess to give him national stature. Over the past three years he has developed an elite mobile force, several hundred strong, whose units help local guerrillas plan and carry out attacks on positions held by the Russians and their allies. Mr Massoud has on occasion persuaded guerrilla bands from different provinces and of different political views to co-operate in major operations. He has won support from the local

population by running health, agriculture and education programmes, paid for by taxes on local trade.

If Mr Massoud were in a position to do these things throughout the country, the resistance could build up a united army and more or less stroll into Kabul. But Mr Massoud's nominal masters in Peshawar (and their Pakistani backers) do not want him to be so powerful. They give him weapons to keep him loyal, but prefer commanders whom they feel better able to control. These are the people they will depend upon to take the capital, possibly with advice from the Pakistani army.

Pakistan's President Zia ul Haq seems to have decided that, however Kabul is taken, Mr Gulbuddin Heckmatyar, current head of the resistance alliance, should control it. Mr Heckmatyar was in bad odour with Pakistan earlier this year, because too many murders in Peshawar were laid at his party's door. In his favour, however, are his tightly-knit party, the Hezb-i-Islami, and a vision of an Islamic state similar to President Zia's.

The designated head of the planned new interim government, Mr Ahmed Shah, is a fundamentalist of the Wahhabi persuasion, a sect found mostly in Saudi Arabia that is notoriously intolerant of deviation. According to the proposed constitution, laws will be based on a Sunni school of jurisprudence, which will be unacceptable to the 20% of the population that is Shia. The Shia Muslims, who are to have no representation in the proposed government, may then turn to their Iranian co-Shias for help.

In the end the best commanders, including Mr Massoud, may decide to go it alone,

leaving Kabul to Mr Heckmatyar and his followers, and running their own bits of Afghanistan as they think fit. The brave new Afghanistan could turn out to be an exceedingly loose-knit place. But it would at least be an Afghanistan without the Soviet-imposed communist government that most Afghans, whatever their other differences, agree they loathe.

China

One step back

FROM OUR CHINA CORRESPONDENT

DESPITE double-digit inflation and its attendant grumbles of discontent, Mr Zhao Ziyang, China's party leader, says that "our confidence" in the policy of economic liberalisation is unshaken. More prices will be freed to find their own levels; the state will further lift its heavy hand from the market. One of Mr Zhao's favourite economists, Mr Li Yining of Beijing University, says bluntly, "The biggest danger is not rising prices... but the return of the traditional system of planning." Why then are China's city-dwellers being given cash hand-outs that amount to 10% pay rises?

The short answer is fear. China has about 200m people who live in cities or big towns, and who spend more than half their incomes on food. The reforms that began in the countryside almost ten years ago may have pleased the 800m peasants but, because food is dearer as well as much more plentiful, they are cutting living standards

Benazir, volume one

AUTOBIOGRAPHIES, like kiss-and-tell memoirs, usually mark the end of the author's career. Is it not a bit ominous, then, for Miss Benazir Bhutto to embark on one at the age of 34 (and just after her marriage)? No, this is only volume one, she says. Miss Bhutto, whose popularity has slumped since her triumphal return to Pakistan from exile two years ago, may hope to regain a bit of sympathy by it. She was anxious, during a trip to London to visit her publishers, to correct a few misconceptions.

People accused her of being arrogant, she said, simply because she was a woman with a strong personality. Mrs Thatcher had the same problem. Yet if it were otherwise they would call her wishy-washy. She was said to have split her Pakistan People's party by refusing to take advice. But it was no more divided than in her father's day, when it held power, and anyway many of the defectors had been

bought or intimidated into defection by the government.

Some critics said her policies were no different from President Zia ul Haq's. What nonsense, she explained. She had objected to the constitutional amendment of 1985 which drew a veil over actions taken under martial law. She disagreed with the government's selling of "sick" nationalised industries cheaply to favoured friends. President Zia, she claimed, turned a blind eye to drug smuggling. He persecuted women by his Islamisation programme. He was neglecting the country's infrastructure; the current prosperity amounted to little more than a consumer boom financed by Gulf workers' wages and foreign aid.

Miss Bhutto is disappointed that the Russians have not been made to install a new, coalition, government in Afghanistan before their withdrawal. Pakistan was making a mistake by chiefly backing the

hardline resistance leaders; this would prolong the civil war, and delay the return of the Afghan refugees.

The differences she offers, though, are not all that dramatic. Miss Bhutto has modified her father's socialism and anti-Americanism in an attempt to win over the middle class he alienated. This, however, makes it harder for her to outflank President Zia. Miss Bhutto seems to accuse him mainly of messy government, rather than of trying to do the wrong things.

Would Miss Bhutto, with her "strong personality", govern much better? She is the only opposition politician with national support. But that support was not enough to prevent her party doing badly in last December's local elections. To win the general election President Zia has promised to hold by 1990, she needs to strengthen her party organisation and develop a programme which is more than a simple condemnation of the government. Otherwise there may be no call for volume two.



They gave me more money to buy these, and now you're charging more

For many urban workers, especially government employees on fixed incomes.

When Mr Zhao and his colleagues seek foreign parallels of communist reform they fix their eyes on Poland—and perceive a nightmare of workers' riots. When they look to their own history, they see inflation helping the downfall in 1949 of Chiang Kai-shek's Nationalist government. The panic buying in China today of soap, matches, pork and eggs feeds inflation and scares even confirmed optimists like Mr Zhao. General Jaruzelski has only 37m Poles to worry about; Mr Zhao has 1 billion Chinese.

Hence the decision, disclosed this month, to cushion the consumer from the latest round of price increases. Price controls on vegetables, pork, sugar and eggs have been lifted. In Beijing's markets, pork will soon cost on average 50% more than it did last month; eggs 28% more; cabbage 30% more; and sugar 58% more. According to the authorities, the typical breadwinner

now has to spend an extra Rmb9.8 (¥7.70) a month on food to support his family. Since the average urban wage is only about Rmb90 a month, that is a lot.

Trying to please everyone

This is why government employees and pensioners in Shanghai and Beijing are being paid an extra Rmb10. Students (as prone to demonstrate in China as elsewhere) will get Rmb8 more. To nervous politicians, this makes sense. To believers in the market (which China's leaders half-claim to be) it looks suspiciously like cowardice.

Subsidies have distorted the price mechanism ever since China began being communist. Now the authorities are cutting subsidies on goods and handing out cash to people instead. So prices and incomes will both rise, and instant inflation will follow, with the possibility of more later: in which case, a new sort of market distortion will replace the old one. Still, the authorities' cau-

tion is understandable. It is only 16 months since the liberalish party leader, Mr Hu Yaobang, had to be sacked to appease Marxist traditionalists.

Also, the subsidy cushion is not as comfortable as it might appear. The cash will be paid to consumers by city governments, factories, hospitals and so on. The efficiency-encouraging hint is that the central government will be loath to reimburse these local bodies. With luck, this could mean that some places will pay smaller supplements than others (and some cities may decide to pay none at all, especially when the autumn harvest increases food supplies).

Righting China's economy will take more than central-government hints and Mr Zhao's enthusiasm. When the World Bank recently rewarded China's decision to end grain subsidies in two areas by providing a "policy adjustment" loan of \$300m, its president, Mr Barber Conable, said, "The law of supply and demand provides better control of inflation than efforts to manipulate prices politically." Mr Zhao and his mentor, Mr Deng Xiaoping, doubtless agree. But most people in China, including most members of its Communist party, have never heard of the basic law of economics.

Mr Zhao is fighting to change a system in which corruption is rife and it is still almost impossible to fire bad workers and reward good ones. So far, the idea of "contract responsibility"—in which an individual or enterprise can make money on the free market after fulfilling an agreed quota—is having only a limited impact.

Reality is a depressing antidote to Mr Zhao's optimism. Of the 235 large industrial projects completed between 1984 and 1986, only a quarter are operating at or near their potential, and 46 are running at a loss. This month China's factories were ordered to stop making refrigerators, air conditioners, washing machines, sewing machines, even bicycles, without special permission. Why?

Because the producers are so deaf to market signals that factories have now made more than 20m watches, 7m electric fans and 10m bicycles so badly that they cannot be sold even to the unpernickety Chinese.

Japan and North Korea Still, there's trade

FROM OUR TOKYO CORRESPONDENT

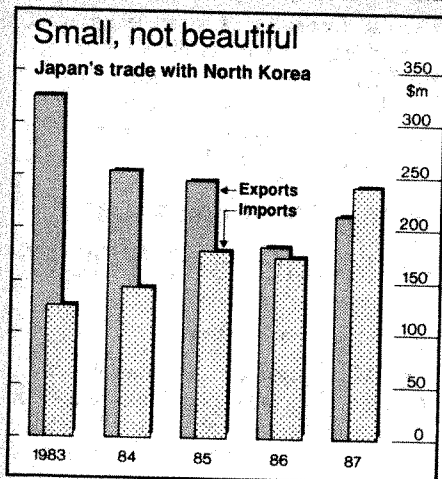
ADMIRE Japan for showing tolerance to the intolerable North Koreans. It allowed some of them into Japan this week to play in the Asian table tennis championship in Niigata. The Japanese government had been cold-shouldering North Korea since its apparent blowing up of a South Korean airliner last year. Why change now? Because the Japanese had been hoping to persuade North Korea to attend this year's Olympics in Seoul, South Korea's capital.

It did not work. The head of the North Korean team, Mr Li Jong Ho, rejected a proposal by the president of the International Table Tennis Federation, Mr Ichiro Ogimura, who happens to be a Japanese, that North Korea should turn up for at least the table tennis events in Seoul (where it might win medals). North Korea was unlikely to be in Seoul for anything, Mr Li said.

Japan feels it ought to be edging up to North Korea. About 260,000 North Koreans are reckoned to live in Japan, more than any other lot of non-Japanese except South Koreans. Although the two countries have no diplomatic relations, Japan would like closer links with North Korea as a way of matching the new closeness between China, North Korea's old ally, and South Korea, its old opponent. One good shift of allegiances deserves another, the Japanese reckon.

So far Japan's relationship with North Korea is mostly one of trade. It is North Korea's main non-communist trading partner, accounting for 10% of all North Korea's trade and more than two-thirds of that with capitalist countries. But for Japan this is small beer: last year the two countries' trade was worth only \$450m, with a small surplus in North Korea's favour. Apart from the blown-up airliner, Japan and North Korea have been at odds over two Japanese seamen seized by the North Koreans as spies and sentenced to 15 years' hard labour. Apparently this was in retaliation for Japan's refusal to return a North Korean soldier who had stowed away in a Japanese ship.

Any improvement in all this, it is now recognised in Tokyo, will have to wait until after the Olympics. Japan's refusal to admit North Korean officials into the country, imposed after the airliner disaster, will be reviewed then. If North Korea sabotages the Olympics (either in Seoul or in Japan, where the Olympics teams of the 35 nations will be



training and through which about 80% of the visitors to the games will pass), the frost will return. Since both Russia and China will be taking part in the games, a rational North Korea would know it will hurt itself by disrupting them.

The Japanese Red Army, however, may do North Korea's dirty work for it. This month the Japanese police arrested Mr Yasuhiro Shibata, one of nine Red Army members who in 1970 hijacked a Japanese airliner to North Korea, where the group took refuge. It now turns out that since 1986 Mr Shibata has been back in Japan, where he is suspected of planning to sabotage the Olympics. The Japanese foreign minister, Mr Sosuke Uno, says that Mr Shibata could hardly have left North Korea and re-entered Japan without the co-operation of the North Korean authorities.

Vietnam

Feed us

FROM OUR SOUTH-EAST ASIA CORRESPONDENT

THE people who run Vietnam, like other third-world left-wingers, have tried to fight a war, establish socialism and feed their people all at once. The Vietnamese communists did well with the war and disastrously with the feeding. They now say they face a famine, and ask for compassionate aid that could rescue their fading authority.

There is some doubt about the severity of this famine. The Vietnamese, to be sure, are adding to their population of 60m more than a million extra hungry mouths a year. And for two successive years rice production has fallen. In 1986 18.5m tonnes of food were produced. That fell to 17.6m last year. This year's target of 19m tonnes is well ahead of the likely result.

In the north of Vietnam, food production has fallen well short of what it should have been. The government is dramatising this in broadcasts over Radio Hanoi. Offi-

cials say 4m people are "near starvation" in the north, and 120,000 tonnes of rice are urgently needed from abroad, to see them through to the next harvest in two months' time. Some international aid people say around half that might be enough.

The south does better than the north because it is more fertile, and still has some fairly efficient small private farms. The north is dominated by huge, ill-managed collective farms, and hit hard by bad weather and pestilence. Southerners have enough rice, and maybe some to spare. Northerners are hungry, but not on the whole badly malnourished. Visitors say the few people who have died were old and frail.

A competent government would buy rice in the south and ship it north. But Vietnam's inflation is still shooting up. (The black market rate of the dong to the dollar has fallen from 1,000 to 3,000 since January.) Farmers are reluctant to hand over their rice for worthless dong.

To support the government's claims of famine-around-the-corner, the number of Vietnamese refugees arriving in Hongkong has leapt to around 100 a day, nearly six times the number at this time last year. Boat people have in the past come mainly from southern Vietnam, whence escape was easier, especially for the better-off. The latest refugees, mostly from northern Vietnam, are arriving in Hongkong in a rough state after two weeks at sea, but not generally starving. Some people think they are fleeing not from famine but from the country's general economic failure, and the political distortions that cause it.

The flow of refugees reinforces the Vietnamese government's laments about hunger as a way of underlining its request for American aid. The United States, the government assumes, would be embarrassed if people started to die of hunger in Vietnam because America would not help. The Americans decline to help Vietnam because its soldiers are occupying Kampuchea, and because its government is slow to track down and return the remains of American soldiers missing in action in the Vietnam war. The international aid agencies, which would like to help, observe that Vietnam has promised to pull out of Kampuchea by 1990 (the Americans are rightly sceptical), and is returning more American corpses (it recently handed over 23).

For many Americans, it is an irony that the hand which beat them 15 years ago is now extended for alms. Some American congressmen say their government should encourage the Vietnamese version of Russia's "restructuring" (*doi moi* in Vietnamese). They propose moving towards diplomatic relations, by setting up "interest sections" in Washington and Hanoi. If famine really took hold, the *doi moi* hopes of Vietnam's new leader, Mr Nguyen Van Linh, would be at risk. Plenty of old-guard

Vietnamese politicians would like to go back to hardline Stalinism, which did no work but kept them in power. But is the new guard really new, and is *doi moi* really much of a change?

India

Golden moment

FROM OUR INDIA CORRESPONDENT

THE past week's fighting at Amritsar's Golden Temple has been dramatically different from that of June 1984, when the Indian government made its previous bid to flush armed secessionists out of the holiest of Sikh shrines. In 1984 Mrs Indira Gandhi sent in the army, which succeeded in capturing the temple but killed about 1,000 people in doing so, and created a fury among India's Sikhs that gave the secessionist cause just the fillip it needed. This time the operation, which began on May 9th, was handled by picked paramilitary units. They made no attempt to reach the central shrine, the golden-domed Harmandir Sahib, and refrained from firing at it.

Instead they ringed the whole temple area, firing at the armed militants if they tried to move about in its grounds, and cutting off the electricity and water. In the torrid heat of May, a week of this war of attrition was enough to break the nerve of most of the militants. On May 15th more than 100 threw down their guns and surrendered; they included several notorious terrorists who are held responsible for scores of recent murders. A hardcore group retreated into the sanctuary of the Harmandir Sahib and held out there for three more days, but 46 of these gave themselves up on May 18th, while three committed suicide and two who made an attempt to escape were killed.

The surrender represents an important tactical victory for Mr Rajiv Gandhi's government in its struggle against the Sikhs who want to establish an independent state called Khalistan. Not only has it destroyed the nerve centre of secessionist operations in Punjab, but it has done so without seriously offending Sikh religious sentiment.

In March, when the prime minister released from detention five Sikh high priests who were close to the secessionists, and offered to talk with the militants themselves if they would renounce violence and seek a solution within the Indian constitution, they took this as a sign of weakness. They stepped up their campaign of killings in Punjab; and they began to fortify the Golden Temple once again.

Their leaders made no secret of their belief that the battle for Khalistan was more than half over. All they needed, they thought, was to provoke the government into launching another assault on the

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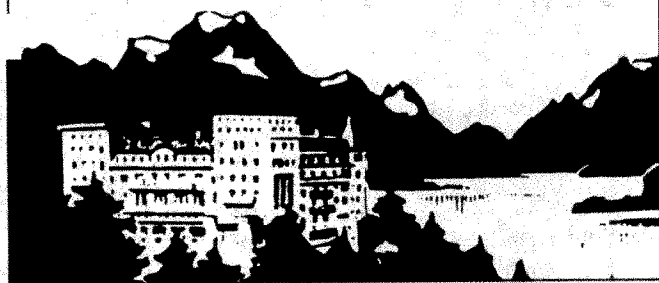
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Golden Temple. This was probably the intention that lay behind the shooting of a senior police officer near the temple on May 9th. But Mr Gandhi, unlike his mother, did not oblige them. The authorities' response was an operation designed to limit both casualties and damage to the buildings.

Now the secessionists have lost some of their most important leaders and a good

many rank-and-file militants, and have nothing to show for it. The people of Punjab have been reminded just how far away the goal of Khalistan really is. In the three days that followed the surrender on May 15th, Sikh terrorists in other parts of Punjab reacted furiously, indiscriminately killing more than 50 Hindus. But if the government handles these retaliatory actions as ca-

pably as it handled the Amritsar siege itself, it will have seized the initiative from the militants and be well placed to resume the search for peace in Punjab. Mr Gandhi has already signalled his desire to restore normality to the ravaged state, by announcing that he hopes to hold an election there within the next six months.

Five-handed poker in the Spratlys

WHEN five governments all make claims on a group of islands, the fact that its land area is negligible may not prevent it becoming a dangerous place. The Spratlys are mere specks in the South China Sea; the biggest, of about 100 acres, would fill only an eighth of Manhattan's Central Park. But new developments in international law could make the possession of these islets and reefs confer rights to all the oil found beneath about 150,000 square miles of sea. Moreover, the Spratlys—which served as a base for Japanese submarines in 1941-45—lie alongside the vital sea route that links the Indian and Pacific Oceans, and midway between the Soviet naval base at Cam Ranh in Vietnam and the American one at Subic Bay in the Philippines.

Until a few months ago, the garrisons planted in the Spratlys by four governments were coexisting peacefully. Several of the western islets had been held by Vietnam since 1975, several of the eastern ones by the Philippines since 1971; Malaysia had staked out claims in the south; and Taiwan had maintained a garrison ever since 1956 on an islet near the centre of the scattered group.

Then China decided to use its new naval power to assert its claims. Ignoring—significantly—the Taiwan garrison, it chose to land marines on islets near some of the Vietnam-held ones. The upshot was the naval fight on March 14th, after which Vietnam said that the Chinese had sunk two of its ships and that 74 of its men were missing.

Angry exchanges followed. The Vietnamese accused China of obstructing their attempts to salvage their ships and search for their missing men; China retorted that they were “continuing to seize Chinese islands, on the pretext of carrying out rescue operations”. Vietnam proposed negotiations; the Chinese foreign ministry called this a hypocritical move intended to cover up Vietnam’s “aggression and expansion”.

In mid-April Vietnam described the arrival in the Spratlys of a new Chinese “surveying team” as an “extremely grave development”, and by May 7th, when

Vietnam’s defence minister, General Le Duc Anh, visited the islets, it was protesting that the Chinese had occupied seven of them.

Meanwhile, what of the other three interested parties? Vietnam’s offer of negotiations has been extended to Malaysia and the Philippines as well as China. In early April Vietnam said it had reached an agreement with the Philippines to resolve the dispute without resort to force. Later in the month the Malaysian government urged all parties to negotiate about their claims—declaring, at the same time, that Malaysia would maintain its own rights.

Chinas together, Russia stand aside

Nobody seemed to be offering to negotiate with Taiwan. Its defence minister announced in April that its garrison was being reinforced. More noteworthy, perhaps, was a story in the Taiwan press about a statement made by the same minister to a closed meeting of members of parliament. He was reported to have said that, since the Spratlys were Chinese, Taiwan would, if necessary, help mainland China to “fight against Vietnam” there. He added, however, that this was “theoretical”, as China evidently needed no help.

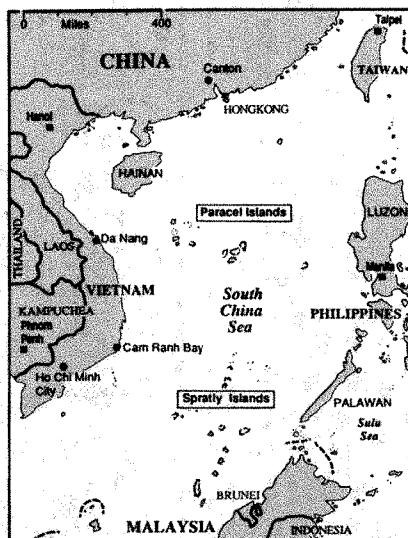
Apart from that intriguing (and un-

confirmed) report, the armed conflict remains, so far, strictly one between two communist states. In an interview published last week in *Asiaweek*, Vietnam’s foreign minister, Mr Nguyen Co Thach, said that the Chinese activity in the Spratlys was meant to obstruct “a peaceful settlement of the Kampuchean problem”. Indeed, China’s chief aim seems to be to increase its pressure on the Vietnamese to withdraw their army of occupation from Kampuchea.

This poses a new problem for the Soviet Union, which is trying to get on better terms with China but cannot afford to alienate the Vietnamese regime that has given it the Cam Ranh naval base. So although, according to Moscow Radio, the Soviet ambassador in Hanoi discussed the Spratlys with Vietnam’s foreign minister in April and said afterwards that his government “completely supported Vietnam’s just stand”, the Russians are clearly reluctant to get dragged in any deeper.

The Spratlys, alas, present a trickier problem than the Paracels, a group of islands lying farther north which China has already wrested from the Vietnamese. Other countries may find they cannot tranquilly watch one communist state ejecting another from the Spratlys, to the embarrassment of a third. Whereas the Paracels lie quite close to both China and Vietnam, the Spratlys’ nearest neighbours are the Philippines and Malaysia. Since the 1970s those two countries have been exploiting offshore oilfields near the Spratlys, and hopes of more finds lay behind the declaration of their claims (which overlap slightly) to parts of the group. Oilmen from the Philippines have already done some test drilling in Spratlys waters.

Neither the Philippines nor Malaysia has ever claimed all of the Spratlys. Vietnam has; now, however, chastened by the Chinese incursion, it is offering to negotiate. But China, although it has hitherto taken care to collide only with the Vietnamese garrisons, is claiming the whole group and rejecting all idea of negotiation. There’s the rub. None of the rival claims has a really solid foundation, but unless China proves more amenable to compromise once it has humbled the Vietnamese, trouble clearly lies ahead.



AMERICAN SURVEY



All the candidates' men—and women

WASHINGTON, DC



From the depths of think-tanks, universities and law firms, the great and the good of American politics are emerging to test the breeze. How best to persuade

one of the two presidential candidates to give them a job? The candidates are bulking out their campaign staff. To the strategists and organisers and media consultants, they are adding people who know the answers to great questions: issue experts. In doing so, they are beginning both to reveal and to shape the policies they would adopt were the electorate to choose them.

The two campaigns of Vice-President George Bush and Governor Michael Dukakis have always had a rather similar feel, in contrast to their unsuccessful opponents. Both are tidy teams run by unflustered and friendly baby boomers. Mrs Susan Estrich, who runs the Dukakis campaign, is every bit a match for Mr Lee Atwater, her opposite number at the Bush campaign. Both are tough, sharp and near superhuman in endurance. She was a professor at Harvard Law School before taking over as campaign manager from Mr John Sasso, who resigned

over his role in revealing Mr Joe Biden's debts to Mr Neil Kinnock. Mr Atwater was deputy campaign manager of the Reagan-Bush campaign in 1984.

Mainstream economists

The similarities extend to the economic advisers the campaigns have chosen. Mr Martin Feldstein, a Harvard economics professor, chaired President Reagan's Council of Economic Advisers from 1982 to 1984. He is now advising Mr Bush. One of his students, who served under him at the council, was Mr Lawrence Summers, now also a Harvard professor. He is advising Mr Dukakis. They hold similar views. Both fear the deficit and favour raising taxes to deal with it. Indeed, it was for constantly recommending this that Mr Feldstein fell out with others in the Reagan administration and left.

Such advice sits less oddly with Mr Dukakis than it does with Mr Bush, whose devotion to what he once called voodoo economics seems to have been strengthened by seeing so many predictions of doom from people like Mr Feldstein not come true. Mr Bush categorically rules out a tax increase,

while Mr Dukakis speaks of the need to raise taxes only as a last resort. When President Reagan's bipartisan commission on the deficit reports in December that new taxes are needed, it will probably get whichever man won the election off the hook of his promises. The choice of Mr Feldstein and Mr Summers as advisers suggests that Mr Dukakis is listening to conservative Democratic economists while Mr Bush listens to mainstream Republican ones. They are both, in other words, moving to the centre.

Yet, if they agree on the importance of reducing the deficit, the two campaigns' advisers have different (though similarly vague) recipes for doing so. Mr Bush is talking to Mr Michael Boskin, a professor at Stanford University, who is a fairly orthodox economist sympathetic to aspects of the present policy of macroeconomic management: let the dollar fall, freeze spending and hope for growth. The architect of that policy, Mr James Baker, the treasury secretary, is a close friend of Mr Bush from Texas days and was his campaign manager in 1980. In a Bush administration Mr Baker might become secretary of state. His successor at the Treasury could be either his own protégé, Mr Richard Darman, or Mr Nicholas Brady, who chaired the president's commission on last year's stockmarket crash.

Mr Dukakis, by contrast, is listening mainly to microeconomists; he is a detail man. His main policy for dealing with the deficit comes from Mr Ira Jackson, a close friend who, as state revenue commissioner, dug him out of a huge deficit when he regained the Massachusetts governorship in 1982. His technique then was to offer an amnesty to tax cheats and to crack down on those who would not take advantage of it. It brought in \$3 billion over four years.

Mr Dukakis is also advised by Mrs Rosabeth Moss Kanter of the Harvard Business School, an expert on entrepreneurs, and Mr Robert Reich of the Kennedy School of Government at Harvard, whose book last year, "Tales of a new America", nicely caught the mood of economic nationalism then waxing, without endorsing xenophobic or protectionist remedies. Mr Reich is an advocate of a mild form of industrial policy, but that is the closest any of Mr Dukakis's advisers get to taking into account the views of trade unions. On Capitol Hill Mr Dukakis has developed notably good relations with Senator Bill Bradley, whose views on third-world debt and the Soviet Union are beginning to appear in Mr Dukakis's remarks.

Mr Dukakis, it will be observed, is picking freely among the brains of Harvard,

where he went to law school and later taught at the Kennedy school. (Mr Bush went to Yale.) This is not surprising, since Harvard likes to play host to a sort of Democratic government in exile during Republican administrations. The governor's issues director, Mr Chris Edley, comes from the law school; three of his main advisers on economic policy are from the university, the business school and the Kennedy school respectively; the fourth is Professor Alan Blinder of Princeton.

Harvard disarmers

Four of his five main advisers on foreign policy—Mr Graham Allison, Mr Albert Carnesale, Mr Joe Nye and Mr Robert Murray—are from the Kennedy school. The fifth, however, Mrs Madeleine Albright of Georgetown University in Washington, DC, is the closest to the candidate.

Mrs Albright, like Mr Summers, is probably further to the right on the political spectrum than Mr Dukakis. She was on the National Security Council under Mr Zbigniew Brzezinski and before that worked for Senator Edmund Muskie, who later became secretary of state. Mr Dukakis has especially encouraged her to cast widely in search of advice to help him offset his image of inexperience and softness. The four Harvard professors are disarmers, but not peaceniks. Three of them (minus Mr Murray) have just edited a book, "Fateful Visions", that concludes after much scrutiny that there is no alternative to deterrence.

Nonetheless, the more hawkish Democrats are mostly disappointed by Mr Dukakis. Mr Jim Woolsey, a missile strategist who was on President Carter's National Security Council and President Reagan's Scowcroft commission on strategic forces, was one of a group who met Mr Dukakis and concluded they could not work with him. (Mr Woolsey was at Yale.) The arms-control experts are especially displeased that the governor opposes the Midgetman missile, a single-warhead, mobile weapon that a growing number of experts think is more resistant to a first strike—and so more of a deterrent—than multiple-warhead, and still stationary, missiles like the MX.

If Mr Dukakis leans towards doves, Mr Bush shows every sign of being a hawk. He considers foreign policy his strong suit, having been an ambassador twice, head of the CIA and a much travelled vice-president. As with economic advice, he relies heavily on sources in the administration and on his own staff. But his main adviser on national security, Mr Donald Gregg, is entangled in the periphery of the Iran-contra and Noriega webs, so Mr Bush may have to distance himself from him. On arms-control matters, he listens to General Brent Scowcroft and former Senator John Tower (another Texan), who both served on the president's commission that investigated the

Iran-contra affair. He is also close to Mr John Lehman, who was Mr Reagan's tough navy secretary until last year.

Mr Bush, more than any candidate in recent years, draws his advice from all over the country. He does not have a coterie of Californians, like Mr Reagan, or Georgians, like Mr Carter. Some of his closer friends, such as Mr Robert Mosbacher, who chairs his finance committee, are from Texas, but Mr Atwater is from South Carolina and Mr Bush's favourite congressman is probably Mr Dick Cheney of Wyoming, one of the leading House Republicans.

Mr Dukakis, on the other hand, draws heavily on Harvard and on Massachusetts (not necessarily the same thing). The staffs of the state's two senators, Mr Edward Kennedy and Mr John Kerry (who was Mr Dukakis's lieutenant-governor until his election to the Senate), are helping Mr Dukakis, as are close friends, such as Mr Paul Brontas, his campaign chairman, and Mr Nick Mitropoulos, an informal adviser. Incidentally, note that Mr Bush's campaign has few women in top positions: Mrs Peggy Noonan, who writes some of his speeches, is probably the most senior.

Drugs

No surrender, yet

WASHINGTON, DC

TO FIGHT drugs or to legalise them? The question is not widely debated in America: the unthinkable is not, at any rate yet, being seriously thought of. But the frustrations, the futility and the cost of trying to keep drugs from coming into the country,

and the mounting level of drug-related violence, are leading to open discussion about whether drugs can ever be suppressed. No longer is it just members of the libertarian right who are suggesting that legalisation should at least be considered.

In Congress the election-year debate is confined to the anti-drug war, with congressmen wondering how they can engage real soldiers in the battle. Last month the Senate passed a bill that would have given the anti-drug effort an extra \$2.6 billion. Much of the money would have gone on new equipment for the Coast Guard and the Customs Service. Since this would have bust the budget compromise worked out at the end of last year, the Senate wanted the president to rule that drugs constituted a "national emergency". The House of Representatives, having said no to that stratagem, found itself landed with the responsibility of thinking of something else. It resuscitated a favourite solution: the armed services.

In 1986 the House passed a bill that required the Defence Department to seal America's borders against drugs within 45 days. This died in the Senate, with Senator Sam Nunn heaping scorn on its lack of realism. A compromise was worked out that required the armed services to help the interception agencies with equipment. This arrangement sounded better than it was, since the agencies apparently could find little military equipment of use to them.

This time the House has been more modest, requiring only that the armed forces "substantially halt the unlawful penetration" of America's borders by drug-dealers. It shifted \$475m from the star-wars budget to drug interception. The Senate suggested that the armed services should be put in charge of drug-trafficking surveil-



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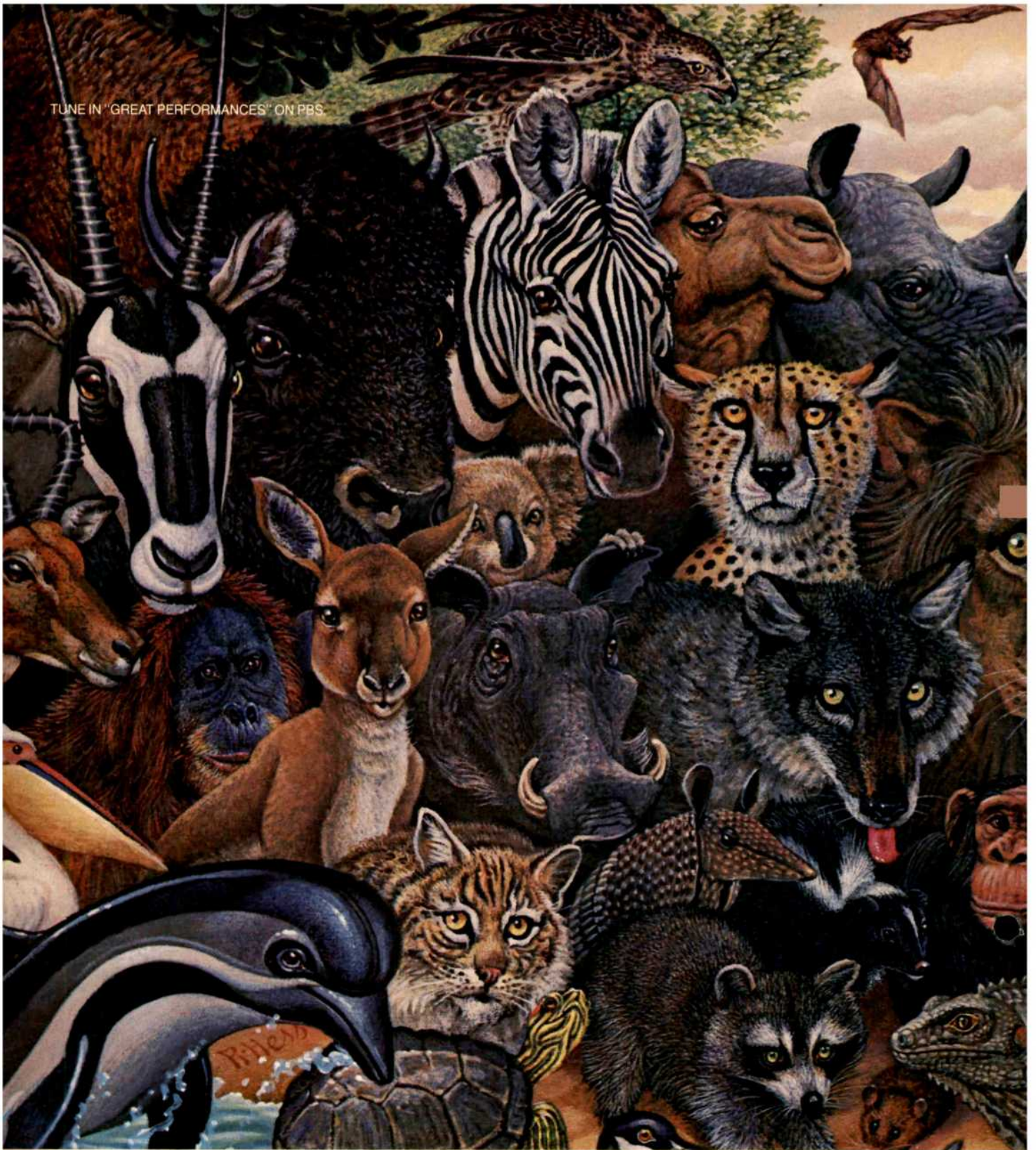
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lance, and that the navy should be given limited powers of arrest in international waters, instead of having to take along Coast Guard officers for that purpose.

For his part, President Reagan has called for a task force to unify America's response to the drug problem. He has also told Mr Frank Carlucci, the defence secretary, to study the best ways to use the armed forces.

Thus, Congress and the president maintain their enthusiasm for interception. But the evidence is that the programme has little impact on the import of cocaine, the drug that attracts most attention. The import price of cocaine had fallen to about \$15,000 a kilogram in Miami last December, almost \$10,000 less than a year earlier. A recent report by the Rand corporation, sponsored by the unhappy Defence Department, argued that smugglers have so many methods of bringing in drugs that expanded interception cannot make much difference to cocaine supplies. Military equipment is not effective against many kinds of smuggling.

In despair, one or two people are starting to explore the alternative of making at least some drugs legal. Baltimore's Mayor Kurt Schmoke, a former prosecutor, was the first elected official to raise the issue. He was quickly followed by Washington's Mayor Marion Barry, and by a Maryland congressman, Mr Steny Hoyer. The *New York Times* and the *Washington Post* have both carried front-page stories on the debate. Television and radio talk-shows are full of the subject. A political scientist from Princeton, Mr Ethan Nadelmann, has published a pro-legalisation article in *Foreign Policy*.

Legalisation has few outright advocates and plenty of passionate opponents. The administration refuses even to consider it. An addicted nation, it says, even if rid of today's violence, would be a lesser nation. Victories are not won by declaring defeat, says Dr Ian Macdonald, the president's drug adviser.

The debate lacks focus. Politicians, hedging their position, point to the uncertainties. How many people might become heroin or cocaine addicts? Could a system be devised that would provide cheap drugs for addicts without making it easy for others to get hooked?

The basic issues have not been looked at since 1972, when Mr Richard Nixon set up the National Commission on Marijuana and Drug Abuse. That commission, though dominated by conservatives, proposed the decriminalisation of marijuana use, a recommendation that Mr Nixon rejected even before the commission had finished its work (the useful distinction between marijuana and hard drugs has all but evaporated these days). Might it be time for another one? It may be worth remembering that the law prohibiting alcohol was repealed by a blue-ribbon commission, headed by a former attorney-general.

Military bases

All defence is local too

WASHINGTON, DC



Assault on the pork-barrel doctrine

REPRESENTATIVE government has its drawbacks, one of which is the tendency for local interests to prevail over the national interest. For ten years superfluous military bases have been protected by their congressmen from any attempt to close them. In 1977 Congress passed a law requiring the federal government to carry out "environmental impact studies" before it closed a base. The procedure—long, expensive and open to legal challenges—has prevented the closure of a single military base since the law was passed. Yet the defence secretary, Mr Frank Carlucci, trying to live within a less ample budget, looks hungrily at the \$2 billion-5 billion that could be saved by closing bases that are no longer needed. He may soon get his way.

The Defence Department estimates that 30, or 10%, of its larger domestic bases could be closed without harming the country's defences. This includes a few splendid outposts such as Fort Douglas in Utah, which protects stagecoach routes, and Fort Monroe in Virginia, which is designed to withstand a broadside from a British man-of-war.

It also includes some newer bases, such as Loring, in an inhospitable part of Maine, which was built after the second world war to place bombers closer to their Soviet targets. In the days of missiles, it is useless. Ten years ago the government tried to close Loring. Senator (then Representative) William Cohen objected, and persuaded Congress to pass a bill requiring the environ-

mental studies. The studies were done, but Loring is still open, Mr Cohen having promoted a law to stop the Pentagon spending any money on closing the base.

In recent years, whenever the Pentagon has tried to close some bases, Congress has always rejected the list. To be fair, the attempts have usually been half-hearted, and administrations have often been as much to blame as Congress for their failure: presidents have habitually tried to close bases as a way of punishing congressmen who have offended them. Only two years ago the Reagan administration recommended the closure of three bases. They just happened to be in the districts of three of its most powerful critics, Mr Tip O'Neill, Mr Bill Gray and Mrs Patricia Schroeder.

Congressmen say they would be neglecting their duties if they did not try to defend the bases, on which whole communities sometimes depend. Yet the history of closed bases suggests that this dependence is exaggerated. Many former bases have become flourishing industrial parks, colleges or commercial airports. An air base in Amarillo in Texas, closed—according to legend—by President Johnson when that part of the state failed to vote for him, now houses a thriving Textron plant. Chippewa County industrial park in Michigan now provides three times as many civilian jobs as it did when it was Kincheloe air base (it was the last base to be closed before the 1977 law).

The proposal now before Congress is an ingenious one. It would set up a commission

charged with finding, within six months, 15-25 superfluous bases; and would require the Defence Department to take the whole list or leave it. By handing over the task to a commission, Congress would in theory remove itself from the argument. The environmental regulations that now prevent the bases being closed would be waived for a while. In due course the commission would be disbanded.

The idea was first raised a year ago by Representative Dick Armey of Texas (there is no Representative Navey) and has had an uneven life since. After a narrow defeat on the measure last year, Mr Armey set about winning more support for it. Newspapers were almost unanimous in backing him. Several influential members of Congress—Senator William Roth, Senator Sam Nunn and Representative Les Aspin—took up the proposal, as did Mr Carlucci. With such big guns booming for it, the measure was attached to the defence authorisation bill, and was passed by a large majority in the Senate on May 10th.

It then got stuck in the House, when two committee chairmen, fearful about bases in their districts, intercepted it. Mr Aspin and Mr Armey withdrew the amendment and turned it back into a bill. Hearings were held this week. The bill has attracted 127 co-sponsors and a promise that it will be guaranteed a vote before the two houses consider the defence-authorisation bill in conference in June. If it passes, the conference will then iron out the differences between the Senate's and the House's measure and pass it into law. The largest of these is an amendment from Senator Alan Dixon giving Congress, like the Pentagon, the power of veto over the whole list.

It only remains to find some upstanding, independent people to form the commission. Mr Armey's original idea was for Congress to appoint some of the members and the defence secretary the others. The Senate's measure would allow Mr Carlucci to pick nine and the president, in consultation with Congress, to pick the other six. Mr Carlucci's list of nine has already been shown to Mr Aspin and Mr Nunn. It includes a former senator, a former representative, two businessmen, a former army secretary and a former navy secretary, two retired generals (one from the airforce) and an environmentalist. All are reckoned to be immune to politics.

According to the Project on Monitoring Defence Organisation, jointly chaired by two former defence secretaries, Mr Harold Brown and Mr James Schlesinger, such a commission would probably succeed in saving money only if it set a target of dollars to be saved rather than bases to be closed, and if it offered some alternatives to simply closing a base. For example, it might recommend selling military research laboratories to private industry. Although this was said

by the Packard commission on defence reform not to be cost-effective, it would have the added benefit that results of research on, for instance, new ceramics for tanks could be shared with civilian industry. With defence almost certainly destined to face further cuts, in years to come, any economies will be welcome.

The constitution

Lid on to keep the worms out

WASHINGTON, DC

FLORIDA'S state Senate has voted this month to rescind the call it made 12 years ago for the United States to hold another constitutional convention. Alabama rescinded its call the week before. The constitution requires two-thirds (34) of the states to call for such a convention before the country may hold one to consider amending the constitution. For five years 32 states have had calls on the books. Earlier this year, Kentucky came close to becoming the 33rd. Now the number is falling again.

Many on the left will heave a sigh of relief. Liberals feared and conservatives hoped that a convention might amend the constitution to ban abortion or mandate school prayer. But what makes this latest episode in a long-running saga so strange is that much of the pressure on Alabama's and Florida's legislators came not from the left but from the right. A few months ago legislators in these states began receiving letters by the thousand from their constituents arguing that the call for a new convention was a ruse to dismantle the constitution altogether in preparation for that old bogey of the right, one-world government.

The constitution is so sacred to Ameri-

cans that it is not hard to whip up fears of a threat to it. Most lawyers believe that a convention could be limited to one issue, the most frequently mentioned being the balanced-budget amendment. But the opponents of the convention have argued that a convention could "run away" and begin tearing up the bill of rights, abolishing the states and altering Congress. Such a possibility is remote indeed, since three-quarters (38) of the states would have to ratify the results of a convention.

Not satisfied by such arguments, various ultra-conservative groups, including the John Birch Society, the Eagle Forum and the Liberty Lobby, have woven a fantastic conspiracy theory about those who call for the convention. Their main target is Mr James Davidson, chairman of the National Taxpayers Union, who has been calling for the balanced-budget amendment for years. Mr Davidson, say his attackers, is immediately suspect because he was educated at Oxford and "an American who goes to Oxford is likely to be a subversive person". Indeed, the campaigners claim to detect "British and/or Soviet influence". Mr Davidson, who is known for his pessimism about the economy, is thus said by the more extreme of the extremists to be part of a group of financiers plotting to cause a depression so that he can profit from it. In the conspiracy with him are the usual *dramatis personae*: Russians, Jews, Rockefellers, the Queen, Mr Robert McNamara.

Poor Mr Davidson insists that he is simply calling for fiscal rectitude. If so, says Mrs Phyllis Schlafly of the Eagle Forum, why has he included on his committee Mr Dick Thornburgh, a former (Republican) governor of Pennsylvania, who is a prominent member of the Committee on the Constitutional System, a group that wants more thorough changes? (This committee argues, quite openly, that policymaking in America would benefit from more quasi-parliamentary



Delete "Congress"; insert "Parliament"

tary party discipline in Congress; it would like to see, for example, congressmen on the same ticket as, and re-elected simultaneously with, the presidential candidate of their party.)

And why, Mrs Schlafly goes on, does Mr Davidson raise money for a balanced-budget drive without making it clear that it would involve a constitutional convention? In all her years, she says, she has never had an issue for which it was easier to garner support than defending the constitution from Mr Davidson. "Plotting to rewrite the constitution" is the headline on one of the leaflets sent out in her name. "Playing Russian roulette with our freedoms", shrieks another.

Much of the momentum for this campaign seems to have come from a part of the fundamentalist religious right, which does not share other conservatives' (including the president's) affection for a balanced-budget amendment and is easily roused by conspiracy theories. Some of the organisers of the Alabama campaign came straight from the Rev Pat Robertson's presidential campaign, and brought with them its lists of contacts. Mr Robertson himself does not share their views. Indeed he wants a balanced-budget amendment. But he has been known to daydream about the threat posed by the secret desire of the liberal establishment (specifically, the Council on Foreign Relations) to impose one-world government on God-fearing Americans.

Edwin Meese

Democrats' delight

WASHINGTON, DC

FORGET any thought that Mr Edwin Meese might be preparing to do the decent thing by the Republican party and resign. Finding him an embarrassment, the party, and in particular Vice-President George Bush, had been rather hoping that the forthcoming publication of a special prosecutor's report would bring matters to a head. But the attorney-general's decision to fire his spokesman, Mr Terry Eastland, suggests that he is determined to battle on, regardless of what Mr James McKay, the special prosecutor investigating Mr Meese's affairs, may eventually have to say.

Mr Eastland, who joined Mr Meese's team in 1985 soon after the attorney-general was appointed, has been sent packing for not defending Mr Meese fiercely enough. That, on the face of it, is absurd: nobody could have presented the attorney-general's case to the press more zealously than Mr Eastland has. He stoutly repudiated the argument that the country's senior law officer should resign just because he was being in-

vestigated. But where, it seems, Mr Eastland erred was in not being prepared to swear uncritical future allegiance in advance of what these investigations revealed.

In his cool letter of resignation, Mr Eastland wrote that Mr Meese sought somebody who would be willing to defend him "against, in effect, any and all criticism". He himself, Mr Eastland told reporters, could not have remained "indifferent" to what might be contained in, or flow from, the special prosecutor's report; as director of public affairs, his job was to serve the Justice Department, and the public, as well as the attorney-general. The McKay report, the result of a year-long investigation into the attorney-general's alleged improprieties, will be published within the next few weeks. It is not expected to advocate anything explicit or savage, but it will document what it has found out about Mr Meese's involvement with Wedtech, a defence company, and with an Iraqi pipeline project. This will allow oth-



Counting his supporters

ers, including the Justice Department's own watchdog committee, to draw their conclusions about any possible ethical lapses.

Mr Meese may have ensured an aggressive defence against any such conclusions (his new spokesman, Mr Patrick Korten, is compared to a pit-bull terrier), but politically he has done himself an injury. Mr Eastland was no simple press man. A conservative intellectual, he had a hand in drafting policy, particularly to do with constitutional issues, and the right wing treasures him as one of its own. "Resign, Mr Meese," thundered Tuesday's editorial in the conservative *Washington Times*. Mr William Bennett, the secretary of education, who himself will be resigning in September, offered Mr Eastland a job (they once collaborated on a book critical of preferment for minorities). "The dumbest mistake Ed Meese ever made" is standard conservative comment. Two of Mr Eastland's colleagues have resigned in protest at his dismissal.

Mr Meese himself contends that it was a simple managerial change, on the same lines

as the decision by the Baltimore Orioles, a baseball team, to change their manager early on this season. The Justice Department, with its top positions unfilled and its officials all scribbling away at their curricula vitae, cries out for inspired management.

Mr Meese's analogy was not carefully chosen. The Orioles had not been doing well under their old manager, but under their new one they have won new fame with a record-breaking stretch of defeats.

Chlorofluorocarbons

On the way out, with luck

NEVER let it be said that America's giant corporations cannot read the writing on the wall. Dow Chemical announced on May 13th that it will begin phasing out the use of fully halogenated chlorofluorocarbons (CFCs) in its products because of fears that the chemicals are damaging the environment. It is the second time in two months that a big company has changed its policy towards CFCs. In April Du Pont, the world's leading producer, announced that it will, over an unspecified period, stop making the chemicals, which are used in plastic foam, freezing and air-conditioning systems and in a decreasing number of aerosols.

The decisions come in the wake of mounting public and governmental pressure against the chemicals. CFCs have been under attack since 1974 when it was first suggested that some of them may be damaging the ozone layer, a shield protecting the earth against the sun's ultraviolet radiation and so protecting human beings against skin cancer. It is believed that, when released, fully halogenated CFCs rise into the atmosphere where they break apart, releasing chlorine. The chlorine combines with the ozone, destroying the shield. Concern over the depletion of the layer has grown over the years with, at first, reports that a seasonal "ozone hole" over Antarctica was growing wider. More recently, the National Aeronautics and Space Administration (NASA) has reported that the depletion may be worse than first believed and that the ozone over the northern hemisphere is also being lost. It was the NASA report that prompted Du Pont's decision to stop producing CFCs.

It was not a small decision. Du Pont controls about 25% of the world CFC market. By dropping out, the company risks handing over some of its share of the market to others, although it will certainly increase the pressure on its competitors to follow suit. Substitutes, which the company says it will now produce, will be expensive.

Du Pont emerges full of virtue from its decision, but it may simply be bowing to the



... and half a pound of ozone, please

inevitable. There were already indications that American CFCs were on their way out, not the least being the attention the ozone layer was given by Senator Albert Gore during his presidential bid (disappointing though that bid proved for the senator).

The aerosol industry, which until the late 1970s used CFCs as spray propellants, was the first hit. When the link between CFCs and ozone depletion was first suggested, aerosol production crashed as American consumers turned to pump sprays, roll-on deodorants and so on. In 1973, the year before the first reports on CFCs were released, some 2.8 billion aerosols were produced in America. By 1982 the number had dropped to fewer than 2 billion, despite the fact that the industry had in effect abandoned CFCs as propellants by 1976 and that in 1978 the government had all but banned their use. (The industry now shows some signs of recovery; aerosol production in America reached 2.6 billion in 1986, only 2% of which contained CFCs.)

More recently, governments have shown an increased interest in regulating CFC use and production in all areas. In September representatives of nations meeting in Montreal under the auspices of the United Nations Environment Programme agreed in general to halve CFC production by 1999. The United States has ratified the agreement—known as the Montreal protocol—and the Environmental Protection Agency is due to issue new regulations in August limiting production of CFCs. Du Pont is actually lobbying the EEC to ratify the protocol, prompting one politician to liken it to a tobacco company calling for a cigarette ban.

As if all this were not enough to cast doubt on the future of CFCs, there are also signs that demand will drop off as a result of

the bad publicity. Dow is not the only buyer of the chemicals to decide that it no longer wants them. McDonald's, a fast-food chain, has announced that by the end of the year it will no longer use plastic-foam containers made with CFCs. The company has 10,000 restaurants worldwide and, as it likes to tell everybody, sells billions of hamburgers. Just more pressure on an already disgraced chemical.

Nuclear power

Short circuited

THE lights may soon be dimming on New York's prosperous Long Island. Even if they do not, the cost of electricity on the island is bound to rise sharply from a level that is already almost the highest in the country.

The story begins in 1968, when the Long Island Lighting Company (LILCO) applied to the federal Atomic Energy Commission for a licence to begin building a 500-megawatt nuclear power plant in Shoreham, on the north coast of the island about 55 miles from New York city. The timing was questionable. Large nuclear plants were already going out of favour. (Since the mid-1970s not one has been ordered by electric utility companies in the United States.)

Shoreham's cost, originally put at \$70m, then rose to \$260m as the power plant's projected size increased to just under 900 megawatts. The cost went on rising. By now the plant, completed in 1983, has cost more than \$5 billion. It will almost certainly never be allowed to operate—the first nuclear project to be shut down before it has fully started up. The fears aroused by the

near-meltdown at Three Mile Island in Pennsylvania in 1979 and reinforced by the disaster at Chernobyl in 1986, plus a deep-seated dislike of LILCO, have doomed it.

Politicians, from Governor Mario Cuomo down, have led the battle to declare Shoreham unsafe; in the event of a disaster, they say, the geography of the island and the crowded roads leading to Manhattan would make evacuation of the surrounding area impossibly awkward. The governor and local authorities have refused to let their police and firemen co-operate in the evacuation drill that must be carried out successfully if a full operating licence were to be granted by the federal authorities. (Shoreham already has a permit to operate at low power.)

An added complication has arisen from the conviction of many of LILCO's customers that electricity would be cheaper if it were provided by a publicly owned state authority. Three years ago Governor Cuomo signed a bill creating the Long Island Power Authority, which was to be allowed to try to take over LILCO if it could show that it could produce electricity more cheaply. Not surprisingly, it reckoned it could. Shoreham would then be shut down. This solution would satisfy the powerful Citizens to Replace LILCO, an organisation dedicated to public control of the electricity supply. Hagglng over the price to be paid has been going on for weeks; the latest offer is just under \$8 billion.

The governor now has a different idea, one that has more appeal for shareholders. Under a negotiated settlement, LILCO would continue to operate as long as it agreed to scrap Shoreham. It would receive compensation for dismantling the reactor, but not the full \$5.3 billion it is estimated to have cost, since the state Public Service Commission has ruled that \$1.4 billion was spent improperly. The extent of the compensation is certain to rile the advocates public power, particularly as the company has received nearly \$500m in rate increases since 1984 to keep it going while Shoreham stood idle.

It also seems likely that LILCO will be promised increases in charges amounting to nearly 60% over the coming decade to compensate it for the high cost of foreign oil that it will have to use. During the past decade its charges have risen by 300%, compared with a national average of about 200%. The governor promises that the electricity supply will be safeguarded by building two sets of gas turbines and up to another three big power plants on the island. But, given that LILCO's managers were far-sighted enough to realise 20 years ago that energy-poor Long Island was going to face an electricity shortage, it seems deplorable that the solution—if it proves to be a solution—has been so delayed and so mismanaged by the politicians.

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Up 27.9%		Up 13.3%		Up 14.0%	

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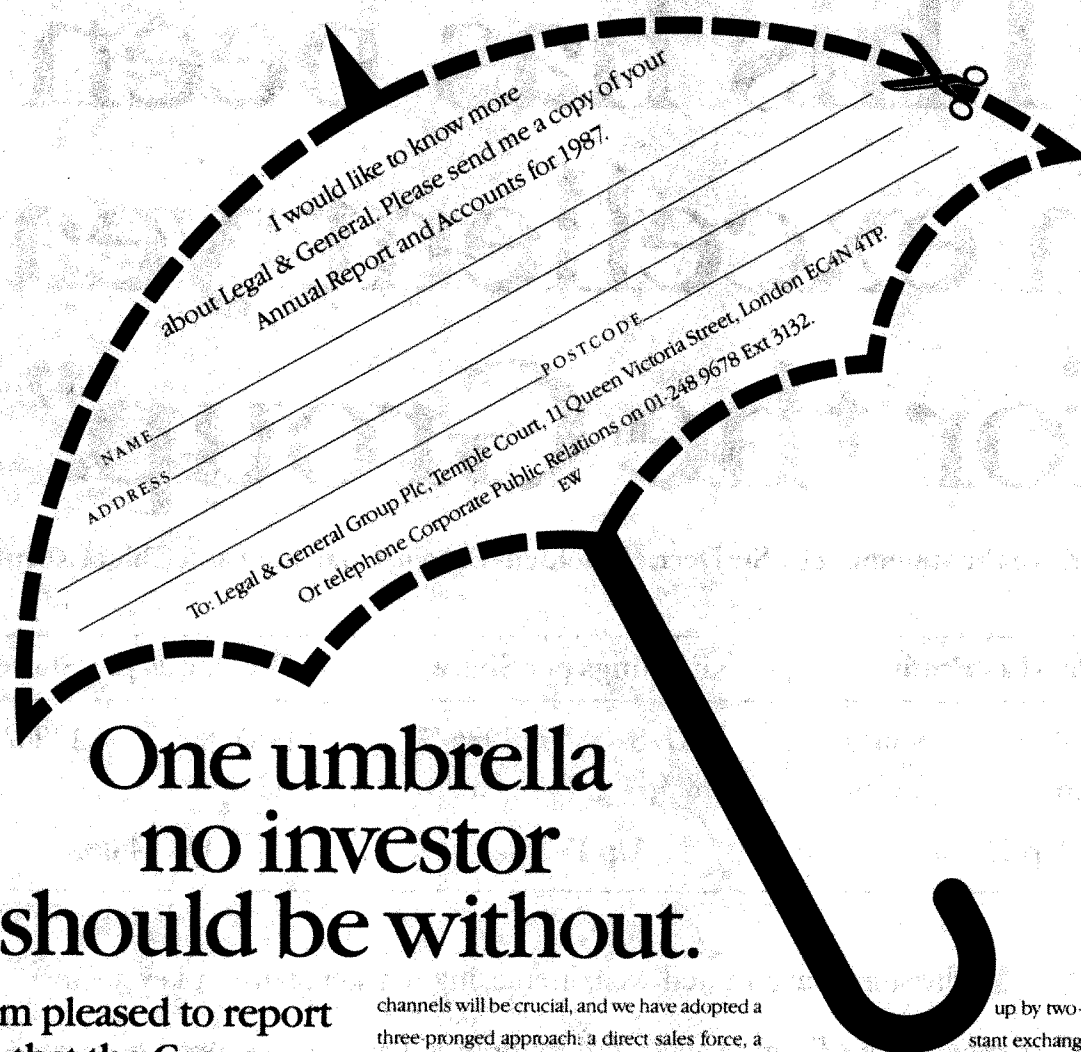
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channels will be crucial, and we have adopted a three-pronged approach: a direct sales force, a large network of tied agents and continuing good relationships with independent intermediaries. I believe our approach of covering all channels is not only the most cost-efficient, but also gives a high degree of flexibility to adapt to changing circumstances.

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"Our international business provided a profit contribution of £22 million last year,

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"The results of Victory and of our US life subsidiary, Banner Life, are encouraging. Our Australian operations continued their exceptionally rapid growth, and our seedcorn operations in France and Holland are developing rapidly.

OUTLOOK

"The first quarter new business figures for Life and Pensions for 1988 are excellent. New annual premium for individual life business is showing 50% growth, and individual pensions business is showing 81% growth.

"1988 has also started well for General Insurance, with a first quarter underwriting profit. We are optimistic that, barring catastrophes, it will be a good year."

Legal & General



The contras slip over the hill

NICARAGUA'S contra guerrillas are collapsing, and with them the country's chances of a tidy peace. In March the rebel leaders signed a truce with the left-wing Sandinist government, and agreed in principle to move their men into ceasefire zones inside Nicaragua by May 30th. For the past fortnight many of them have instead been leaving the country for Honduras. Some of the troops are mutinous, the political leadership divided on how to proceed with the peace talks. The contras' disarray may block negotiations for an extension of the truce. If it lapses at the end of May, the Sandinists say their army is ready to attack.

The contras were never noted for coherence. Some were members of the late dictator Anastasio Somoza's National Guard, others social democrats who worked with the Sandinists for a while after they overthrew Somoza in 1979. They have squabbled their way through seven internal reorganisations and the resignation of two of their most influential leaders, Mr Eden Pastora and Mr Arturo Cruz. Only American guidance, and a tendency to duck awkward decisions, staved off previous crises.

The peace plan put forward last August by Costa Rica's President Oscar Arias has deprived the contras of both those saving graces. It prompted the Sandinists to make some democratic reforms, so forcing the contras to decide whether it was time to resist with ballots instead of bullets. And it persuaded the American Congress to cut off the contras' military aid, so removing the unifying glue of American support.

The most diminished leader seems to be

Colonel Enrique Bermudez, the contras' military commander. In April there were rumours that a rival leader, Mr Adolfo Calero, had tried to grab the military job for himself. This month the challenge to Colonel Bermudez spread to his own troops, many of whom are being forced by hunger out of Nicaragua and into their camps in southern Honduras. Dissident officers claimed to have collected signatures from more than 50 field commanders, roughly three-quarters of the total, on a petition demanding the colonel's resignation. At least 2,000 of the 12,000 or so guerrillas were said to sympathise with the mutiny. On May 18th most of the dissidents signed another statement, this time professing their loyalty to Colonel Bermudez. But by then eight ring-leaders had been relieved of their posts in Honduras and packed off to Miami.

The most senior of these rebels, Mr Walter Calderon Lopez, whose *nom de guerre* is Toño, accuses Colonel Bermudez of failing to devise any serious strategy, of tolerating corrupt assistants who grew rich on American aid, and of co-operating with American plans to resettle contra troops outside Nicaragua—which would amount to admitting defeat. Colonel Bermudez still enjoys American support, and can split the mutinous units into smaller, less threatening groups. But if the colonel stays Toño says he will go, expecting to take others with him. A few desertions could set a fashion.

Toño's indignation at the idea of resettling defeated contra troops suggests that some of them will carry on fighting. They have suffered too much in seven years of war

to knuckle under to the Sandinists. They have also inflicted too much suffering. In southern Nicaragua particularly, local contra warlords have filled small cemeteries with their enemies; no government amnesty would protect them from personal vendettas. Besides, the contras are a young insurgency by local standards. The left-wing guerrillas in nearby Guatemala, with hardly any outside aid, have managed to keep fighting for a quarter of a century.

Among the contra leaders, Colonel Bermudez, Mr Aristides Sanchez and to a lesser extent Mr Calero are unlikely to return to Nicaragua. They are too closely associated with the bad old days of Somoza to have a role there. One member of the contra directorate is conspicuously different. Mr Alfredo Cesar worked under the Sandinists as president of the central bank until 1982. He is clever, young and attractive. In Nicaragua he would have a sporting chance of winning a fair election—particularly if his candidacy were backed by the promise of badly needed American economic aid. He is much keener than his colleagues for the peace talks to succeed.

Would the Sandinists allow a free campaign? Mr Cesar knows better than to expect their swift conversion to democracy. On May 4th four independent radio stations were closed down for eight days after they reported—falsely, according to the Sandinists—that a striking construction worker had been tortured to death. But the Sandinists have one good reason to mend their bullying ways.

Their economy is in tatters. To allow the emergence of an opposition that might beat them in a free election, with or without Mr Cesar, could win them aid from the European Community, and possibly from the United States. More oppression could mean more American guns for the contras who choose to fight on from the mountains.

Free expression

The gag around the world's mouth

IN NORTH KOREA, television devotes about half its time to films praising the country's leader, Mr Kim Il Sung. Novelists are expected to scribble according to a strict output quota, preferably pages which advance the proletarian struggle. In Mexico and Pakistan the state does not control the newspapers but controls the supply of paper they are printed on: publications which oppose government policy are liable to get none. In Ireland newspapers can print what they want, but books like "The Joy of Sex" and "The Erotic Art of India" are banned—

which is nothing to the estimated 18,000 books on the banned list in South Africa.

All this and more is set out in a 50-country survey of freedom of expression by "Article 19", a right-to-speak group based in Britain. The group is named after Article 19 of the Universal Declaration of Human Rights, which upholds the right to freedom of opinion and expression. The report makes glum reading. In only 11 of these 50 countries are newspapers entirely free to criticise their government. In the rest measures against free speech range from the eco-

nomie (withholding of government advertising or newsprint) through the political (government censors) to the downright fatal. In Mexico and Colombia journalists are often killed in mysterious circumstances.

Artistic censorship is widespread, too. In Indonesia any public performance, even a poetry-reading or a play, must be cleared in advance with the local police. Among Congo's list of banned publications is Ian Fleming's "The Spy Who Loved Me". In Pakistan both the love poems of Robert Browning and Charles Darwin's writings on evolution have been purged as "unIslamic".

The countries with the worst records tend to be in Africa, followed closely by those of the Middle East. We should declare our interest. *The Economist* has been

Sharpening the cross

FROM A CORRESPONDENT IN GENEVA



Fair enough. Now let's see the other 14,850

ONCE as secretive as the Geneva bankers who provided many of its members, the International Committee of the Red Cross (ICRC) is changing its style. These days it does not shrink from sharp and public rebukes: of Iran and Iraq for their treatment of each other's prisoners; of Israel for its conduct in the West Bank and Gaza; and of Ethiopia for blocking urgent help to starving people. All have violated humanitarian treaties they have signed, and have been told so.

The 25 members of the ICRC's committee are still all Swiss. But five are now women, and the average age has come down considerably. The new and outspoken president, Mr Cornelio Sommaruga, bears little resemblance to the Calvinist

bankers of ICRC legend. Between 1945 and 1980, a period of 35 years, the Red Cross issued 38 formal protests. In the eight years since then it has made 37, five this year. The change is also qualitative: vague, hardly decipherable utterances have become uncomfortably specific.

The Iran-Iraq war, with six protests since 1983, deserves a sad prize. Having reminded the combatants that civilians deserve protection and that chemical weapons should not be used, the ICRC has turned its mind to prisoners of war. Iran holds some 60,000 Iraqi prisoners, Iraq nearly 15,000 Iranians. The Red Cross says that 15,000 Iraqis are missing from prison camps in Iran. Nearly half of these were on the records kept on the ICRC's vis-

its to the camps up to 1984, when it suspended its visits after the killing of ten prisoners. The rest were known to the Red Cross through messages they had sent to their families. When the ICRC resumed its visits to the camps in November 1986, the prisoners were not there. The Iranian foreign ministry has been asked to explain itself. So far it has not.

Iraq has on the whole treated its Iranian prisoners remarkably well, but since the beginning of 1987 it has not handed in the name of a single new captive. The Red Cross demanded to know why. The Iraqis now admit that they have taken new prisoners, including "many" when they recaptured the Faw peninsula last month. They still refuse to let the Red Cross register them, saying that they are only behaving as the Iranians do. But the principle of reciprocity, Mr Sommaruga insists, has no place in humanitarian law.

Keeping track of prisoners is much easier in Israel. Before December 1987 the Red Cross was regularly visiting 4,000 prisoners in Israel and the occupied territories; since the start of the Palestinian protests there, another 5,000 have been added to its clientele. Its delegates (all Swiss) are allowed to move freely in the occupied territories. In the camps and villages under curfew, they are often the only restraining witnesses on what the Israeli army does. The Red Cross has spoken out against the disproportionate use of force, collective punishments and expulsions.

In Ethiopia, President Mengistu has told the ICRC to get out of the war zone in the north, and leave its relief operations there to the malleable Ethiopian Red Cross. Mr Sommaruga is trying to persuade the president to allow at least three Swiss delegates to stay behind; the ICRC wants at all costs to avoid leaving a war with no witnesses. It remembers horribly well the sequel to its departure from Kampuchea in 1975.

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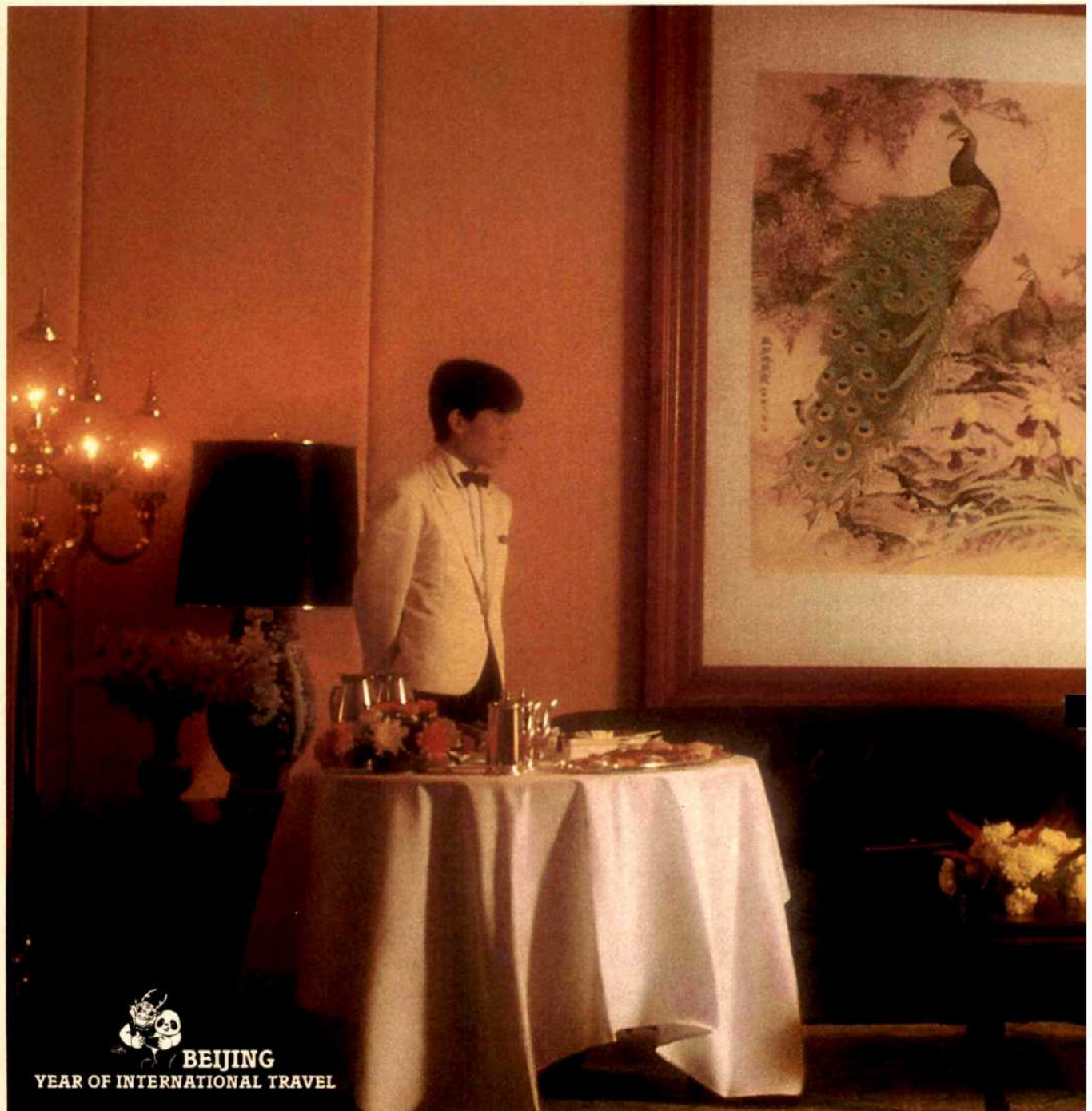
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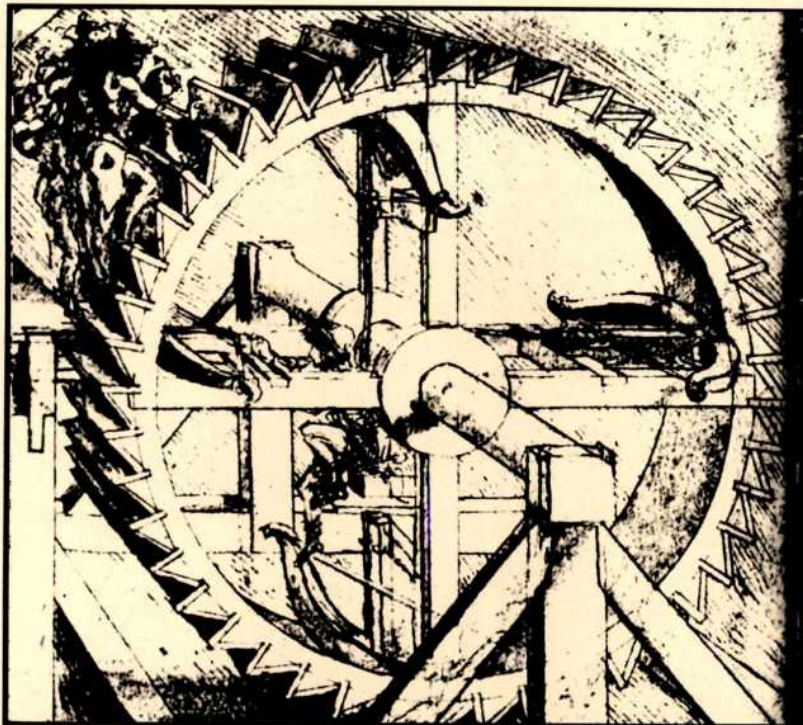
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MID 1990), SHANGRI-LA SINGAPORE. CHINA WORLD HOTEL BEIJING (EARLY 1989), SHANGRI-LA INN PENANG

VISION



A design by Leonardo da Vinci of a crossbow machine gun that enables the archer, suspended inside the large treadwheel, to keep the arrows flying at a rapid pace. The archer's comrades furnish power to the wheel by foot, under the protection of a planked shield.

“Leonardo da Vinci (1452 - 1519) was like a man who woke too early in the darkness, while others were all still asleep,” wrote Sigmund Freud.

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banned by 11 Arab countries in the past two years; Saudi Arabia banned us for six months for suggesting that it had invested its oil billions unwisely. Kenya, Panama, Pakistan, Taiwan and Indonesia have also banned *The Economist*, some of them because the offending issue carried a survey of their country. South Africa has cut out or inked out articles about itself.

Compared with what went before, newspapers in the new democracies of Argentina and Peru have flourished. Honduras is better than most of its Central American neighbours. But in Colombia journalists who speak out about military injustice, drug trafficking or government corruption have been harassed, threatened or killed. They are still admirably brave: after one editor was gunned down, the press organised a day of silence, without newspapers, radio or television, and joined a six-mile march through Jogota. One journalist told *Article 19*: "We're always waiting for the next murder." In Chile two journalists were imprisoned for "insulting the armed forces" after criticising compulsory military service.

In the Soviet Union Mr Mikhail Gorbachev's policy of *glasnost* has made journalists freer to investigate and to debate. Newspapers have exposed police brutality, judicial corruption, the trumping-up of charges by the KGB and conditions in labour camps and mental hospitals. Newspapers have printed articles arguing for the abolition of central planning and of the death penalty, and advocating the introduction of a stock market and secret ballots. Once-banned authors, like Vladimir Nabokov, are now being published and most western radio broadcasts are no longer jammed.

"Information, Freedom and Censorship", *Article 19*. Published by Longman.

Western democracies are still in a different league. But they cannot be complacent. The report criticises the state of Alabama for banning books teaching "secular humanism" from its schools (the case is expected to be heard by America's Supreme Court), and Britain and France have banned books—one on the Bokassa "diamond affair" in France, several on the British security services—for what look suspiciously like political reasons.

Iran Botheration

REVOLUTIONARIES in Iran welcome a spot of bother to feed their fervour. But rarely has Iran been hammered on so many fronts at once. Each new blow makes it harder to extract itself with honour from the Gulf war, which it must now despair of winning. Worse, each requires a "revolutionary response" which Iran is ever less able to deliver without provoking retaliation and so compounding its predicament. France's decision this week to restore diplomatic relations is Iran's only recent item of fairly good news.

The latest knock, a particularly dramatic raid on Iran's oil exports, was not particularly effective. Iraqi warplanes flew 1,000 miles to the mouth of the Gulf on May 14th to attack Iranian storage vessels off Larak Island. They hit five tankers, badly damaging four and killing more than 20 crewmen. Repairing or replacing the ships will cost far less than the proceeds of the oil they carried. Since Iran maintains plenty of spare capacity, its exports are unlikely to dip. But that does not lessen the insult.

Iran accused America of colluding in the attack, by jamming the radar and radios of its aircraft. In revenge its gunboats attacked Japanese and Norwegian tankers, despite last month's announcement that the Americans would extend the protection (but not the convoys) they have been providing for reflagged Kuwaiti tankers to other neutral shipping in the Gulf.

The war with Iraq seems to have settled down into two-way attrition, a state conventionally thought to favour the more numerous Iranians. But Iran's freedom of manoeuvre has been crimped by Iraq's new stock of Russian ground-attack missiles. Iraq got the best of the missile exchanges in the last bout of the "cities war" in March. A month later Iranian troops were expelled from their foothold on the Faw peninsula. Iran's only offensive this year, in Iraq's northern mountains, sputtered back into life this week, but seems unlikely to deliver any decisive gains.

At home, war-weariness is spreading. Two senior ayatollahs have called publicly on Ayatollah Khomeini to accept an honourable peace; they were already known to oppose the more radical direction in which Iran's misfortunes are taking it. But Iran looks incapable of change. Its extremists appear to have emerged stronger from the recent parliamentary election. Suspected Iranian complicity in last month's Kuwaiti airliner hijacking stopped Kuwait from reopening its embassy in Tehran; and threats to disrupt the Haj pilgrimage to Mecca have cost Iran its relations with Saudi Arabia. Now the victories of Hezbollah, Iran's protégé in Lebanon, are damaging Ayatollah Khomeini's delicate alliance with Syria, Iran's only Arab friend. Next year's Ramadan has to be better than this.

Argentina Dirty duty

FROM A CORRESPONDENT IN BUENOS AIRES

THE extradition from the United States of General Carlos Guillermo Suarez Mason has been hailed as a victory for Argentine democracy and justice. So it may be, but Argentina's government is not relishing it. The general's return puts a new strain on President Raul Alfonsín's always tense relations with the country's armed forces. The general, who fled the country four years ago, faces 39 murder charges. As head of the First Army Corps in Buenos Aires province after the coup of 1976 he is alleged to have played a leading role in the "dirty war" the former military regime waged against a small army of brutal urban guerrillas, in which people who had nothing to do with it got murdered.

General Suarez Mason's enforced return will put to the test the law of "due obe-

Two legs bad, if they wriggle

FROM OUR CAIRO CORRESPONDENT

SHEIKH Muhammed Metwalli al Sharawi is not the man to invite to your next party. In an interview with the newspaper *Akhbar el Yom*, the 78-year-old sheikh, Egypt's leading television preacher, has ruled on what should be considered Islamically *halal* (permissible) or *haram* (prohibited) in Egyptian art and entertainment. He deems all dancing bad, especially ballet, because the female dancers wear short skirts. Music is *halal* only if it does not "tickle the nerves", which would seem to condemn 99% of the Middle East's wriggly melodies.

The sheikh preaches on television every week (and every day in the holy month of Ramadan). He does not advocate violence. But his declarations encourage the sort of militants who broke up parties on Egyptian college campuses this spring, in Cairo as well as in the traditionally conservative south. Near Asyut in the south, a student was killed in a demonstration that started when a government theatrical troupe performed near a village mosque.

Some of the fundamentalists' opponents believe the police should do more. Mr Ahmed Baha Eddin, one of Egypt's most-read columnists, says that theatrical performances and student parties should,

if necessary, be protected with tanks. He attributes the new puritanism to the circulation of pamphlets from Saudi Arabia, written by obscurantists "who still think the world is flat". These have a large audience among the millions of Egyptians who have worked in the Gulf states.

Puritanism in Islam, as in Christendom, comes in waves. In the 1930s the founder of the Muslim Brotherhood,



Hassan al-Banna, called for the abolition of all public entertainment. Scholars deny that the Koran condemns music, dancing or singing: they point out that the Sunna, the life of the Prophet Muhammed, says that he had dancers and music at his wedding. But Islamic greenstockings find passages condemning music in the Hadith, a

collection of sometimes contradictory sayings ascribed to the Prophet.

The government of President Hosni Mubarak has reacted with a characteristic balancing act. The state-run television system has increased its output of religious programmes, but there is still plenty of lighter fare, including foreign films and serials. "Dallas" was dropped when it became too much of a national obsession a few years ago, but it was followed by the equally steamy "Knots Landing" and "Falcon Crest". ("Dynasty" will never be shown, say television executives, because one of its main characters is gay.) All foreign programmes are censored. Kisses sometimes get by, if not too passionate. Belly-dancers have been *haram* on television for several years, although they writhe on in broadcasts of old films—and remain a staple item in nightclubs and at wedding and birthday parties.

This year Egyptian television has again broadcast its "Ramadan Quiz", a nightly charade in which performers act out riddles and viewers try to guess the answers to win prizes. Despite fundamentalist grumbling, the show still features music, dancing and opulent (if neck-to-ankle) costumes. But the star of recent years, a comely actress named Sharihan, has been replaced by a plump middle-aged man and two less provocative women. Egyptians think Sharihan was too sexy.

dience". This was rushed through congress after last year's Easter rebellion, under pressure from middle-ranking army officers who want to limit the number and scope of dirty-war trials. The law says that most accused



No fun in generalship these days

officers should go free, because they were following orders rather than initiating crimes. Guilt would be ascribed only to a few senior commanders with responsibility at regional level. The prosecution says General Suarez Mason held such a post.

He has set the cat among the pigeons by claiming that his First Corps command included clandestine jails whose officers were allowed to make their own decisions on the fate of prisoners. Liberals argue that, if officers were indeed given such free rein, they can hardly have been acting on specific orders, and their acts cannot be excused on the ground that they owed due obedience.

Hundreds of officers are thought to have been let off under the due-obedience law in the year since it was passed. They include several generals, four admirals named in connection with torture and detention at the navy's notorious Mechanics School, and many lesser fry. In a ruling issued days after General Suarez Mason was brought back, the high court confirmed that charges will not be laid against a fresh batch of 45 officers, among them the present army chief, General José Caridi.

General Suarez Mason denies all the charges. The prosecutors are determined to make them stick, and want to start the hearing in late July or August. Others wonder

what may come out by then. Before he got away in early 1984, General Suarez Mason said he would not be a scapegoat. He still insists that, like so many others, he was a soldier without ideology, just doing what he was told. The general, nicknamed *Pajarito* ("Little Bird") at the height of his power a decade ago, may start singing.

British Virgins

A better class of pirate

FROM A CORRESPONDENT IN ROAD TOWN, TORTOLA

TWO or three centuries ago the British Virgin Islands, a volcanic group lying east of Puerto Rico, were used by buccaneers such as the infamous "Blackbeard" Teach as a base for attacks on ships carrying booty from the Americas to Spain. Today a new kind of foreign booty is flowing in, and this time it is legal. In the past three years, so many offshore companies have been incorporated in the islands that there is now one of them for every two of the 12,000 inhabitants. General Noriega's troubles in nearby Panama have accelerated the shift to this

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In 1984 the British Virgins decided to bid for a slice of the Caribbean's offshore-capital business, which was mostly going to another British dependency, the Cayman Islands, or to Panama. The self-governing islands' legislative council adopted a law that made it both cheap and simple to register businesses there. With solid British law behind them, the islands offer the convenience of dealing in United States dollars, their official currency.

The effort was an immediate success. From the start of the operation in 1985 to the end of last year, 4,450 companies had been formed. In 1988, with Panama in turmoil and its banks closed, the number of incorporations in the British Virgins has rocketed. Between January 1st and April 30th, 2,122 new businesses were added to the list, and the government had to buy its first computer, to keep pace with demand.

Many companies' presence in the islands is not much more than an official address. But the boom does wonders for government revenues. In 1987 incorporation fees provided \$2m of the islands' \$24m budget. The colony balanced its books without a direct subsidy from Britain.

Island officials expect that the financial centre will free the economy from almost total reliance on tourism, and provide relatively well paid jobs for skilled office workers and managers. In the little capital of Road Town, on the main island of Tortola, the demand for office space has speeded up the modest construction boom that began when the tourists started to arrive. The islands have waited a long time for the good times. Sir Francis Drake exploited the area's fine



Blackbeard never incorporated

sailing conditions by assembling 27 ships there to attack a Spanish treasure fleet in 1595. Only in the past 15 years have modern yachtsmen been attracted, by skilful promotion of secluded coves, unspoiled beaches, steady winds and balmy weather.

Now foreigners drawn by a mixture of warm sun and an expanding economy stream in from Canada, Britain and America. The courts are clogged with disputes about the ownership of land that recently lay unused and unwanted. Mr Vernon Pickering, a local newspaper editor and historian, says that residents are, for the first time, voicing concern that development may outstrip the islanders' ability to absorb it. "We are a small community and we need time to digest", he says in the lilting accent of the islands. "But I don't see it being negative. I think we have a good future here."

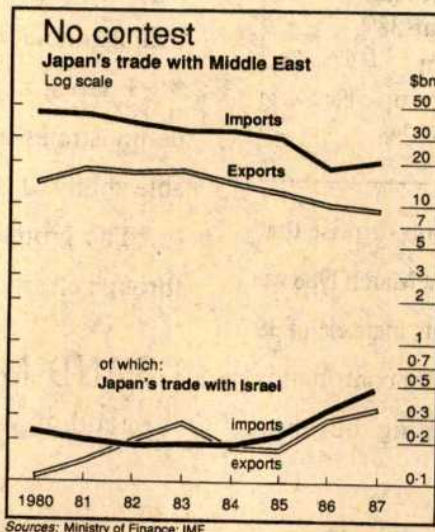
Japan in the Middle East

Israel braces for Uno who

FROM OUR TOKYO CORRESPONDENT

WHEN he stops off there on his way home from the non-communist world's Toronto summit next month, Japan's foreign minister, Mr Sosuke Uno, will become the first-ever Japanese cabinet minister to visit Israel. The Americans are being invited to see the visit as evidence that Japan is not as ploddingly pro-Arab as it often seems. Here too Japan is venturing out, timorously, on to the world stage.

Japan's foreign policy is still dominated mainly in yen. Despite some fierce pro-Israel lobbying by the Americans, Japan has stuck with the Arab economic boycott of that country. It depends on imported oil, and buys 70% of it from the Gulf. The Muslim Middle East is a good market, too. In 1987 the region bought goods worth \$9.2 billion from Japan, and its exports to Japan (three-quarters of it oil) were worth \$20.2



billion (see chart). Japan's trade with Israel was worth a mere \$586m in 1986. Israel is one of the few countries where Toyota and Nissan do not try to sell their cars. It does not have the usual Japanese government trade-promotion office. Talk about trading with Israel is taboo in Japan; South Africa is considered far more respectable.

Over the past couple of years, however, the Japanese have slowly responded to American prodding by some mild improvements in relations with Israel. Trade delegations have been sent by small and medium-sized Japanese firms that have no business ties to the Arab world. The smaller carmakers are starting to sell openly to Israel. The foreign ministry has encouraged livelier diplomatic contacts, and has tried to calm down the fuss caused by a spate of anti-semitic books that have become best-sellers in Japan. The most recent ascribes the Chernobyl nuclear disaster in Russia to a Jewish conspiracy.

As in other countries in the same psychological condition as Japan, the foreign ministry is keen on "honest brokerage", and thinks the Middle East a suitable place to try it. If Japan trades with a country, officials explain earnestly, it can also talk to it. Japan often does business with both sides in a conflict. It talks both to Iran and to Iraq, and could talk both to Israel and to the Palestinians. Mr Uno plans to meet Palestinians when he visits Jordan. Mr Yasser Arafat has visited Tokyo. None of this is quite new. Mr Uno's predecessor, Mr Shintaro Abe, visited both Tehran and Baghdad, without in the least helping to end the Iran-Iraq war.

There are other small new signs of Japan's interest in the region. It thought of sending warships to help America and Western Europe keep the Gulf open, but decided that its no-war constitution permitted the despatch of only some navigation electronics. As well as money, it is actually sending a man—one man—to the United Nations peacekeeping force observing the Soviet withdrawal from Afghanistan; it has never done such a thing before.

The Middle East is useful as a kindergarten for Japanese diplomacy. It is far away from Japan's Asian neighbours, who still tend to think that with Japan the step from diplomacy to armed expansion is a short one. Moreover, America, Russia and Europe all pursue their interests in the Middle East. The Japanese feel that such competition offers opportunities to them.

Outsiders may be bemused by these tortuous notions, but Japanese take them seriously as they thrash around for a foreign policy. When Mr Ryohei Murata, the architect of Mr Uno's visit to Israel, became the top bureaucrat at the foreign ministry last year, he promptly dispersed the brightest and the best of his senior officials to embassies throughout the Middle East.

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FINANCIAL YEAR 1987

The Board of the Company has approved the Accounts for the financial year ended 31 December 1987 and these will be presented at the Annual General Meeting to be held in Marseilles on 13 June 1988.

Highlights from the Accounts are given hereunder (in millions of French Francs):

Holding Company	1987	1986
Total Balance Sheet	2,812	2,071
Net Profit	166	155

Group Consolidation

Total Balance Sheet	9,898	8,931
Turnover	15,028	14,489
Net Profit	338	370

The Board proposes the payment of a dividend of Frs 42, which, together with the associated tax credit of Frs 21, will represent a distribution of Frs 63 per share (Frs 60 for 1986). When account is taken of the increase in share capital effected in 1987, dividend distribution will have increased by 44.88% over the previous year.

DEBENTURE ISSUE

The Board will seek approval from an Extraordinary General Meeting, also convened for 13 June 1988, to authorise an issue of debenture stock.

ACQUISITIONS

The acquisitions effected during the second half of 1987 and early 1988 at a cost in excess of one billion French Francs and which include, as previously announced, a majority shareholding in Compagnie de Distribution de Material Electrique (CDME), are expected to increase consolidated Group turnover by some 50% in the current year and to have a significant impact on Group net profit.

Further investment opportunities are under active consideration.

Copies of the 1987 Annual Report and Accounts may be obtained by application to the Registered Office, 32 cours Pierre Puget, 13006 Marseilles, France.

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August 1995

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1987 Financial Highlights		
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Profit on ordinary activities before taxation	116.2	86.1
Earnings for ordinary shareholders	63.1	42.7
Earnings per ordinary share	73.7p	50.2p
Dividends per ordinary share (net)	27.0p	21.0p

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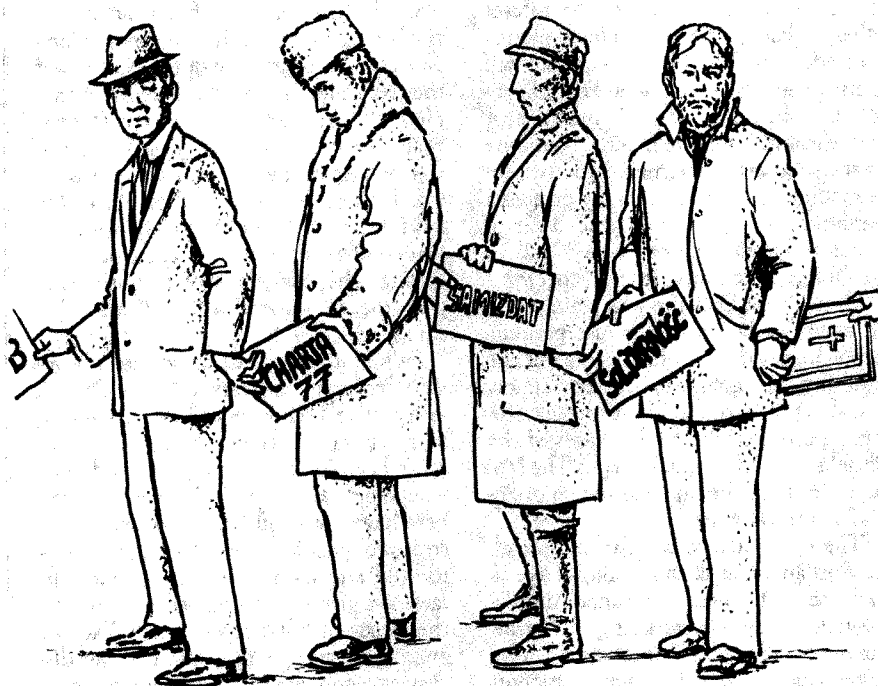
With a strong base of both local and international management, together with a clearly defined strategy, Inchcape is now well equipped to develop and prosper in the years ahead.”

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THE INTERNATIONAL SERVICES AND MARKETING GROUP



ing house in Budapest, claims to have taught the techniques he learnt in Poland in 1981 to "hundreds" of people since. Now such seminars are beginning again in Poland, on a much bigger scale.

Cross-border contacts suffered from the arrival of martial law in Poland in 1981, and from a clampdown in other countries by governments that feared the spread of the "Polish disease". But the contacts have since resumed. Last August a reunion was held on the Polish-Czechoslovak border, attended by eight Poles and 12 Czechoslovaks—among them Messrs Jacek Kuron, Zbigniew Bujak and Vaclav Havel. They signed a joint declaration, and a short video film of the meeting has since been widely distributed in both countries. Such meetings "have only symbolic importance now," says Mr Kuron, "but they will certainly take on greater significance after the collapse of the Soviet empire."

These contacts are only the most eye-catching sign of a growing East European curiosity about what the neighbours are thinking. At least four Polish underground monthlies are now devoted exclusively to developments in other communist countries. The rest of the underground press in Poland is full of translations of opposition literature from Eastern Europe, articles on regional history and essays on the meaning and future of "Central Europe". Although the underground press is less developed outside Poland, the trend of interest is the same. The Hungarians have just printed, in impressive *samizdat* editions, a series of novels by a Czech émigré writer, Milan Kundera, and a Hungarian version of *Oni*, a set of interviews with Polish Stalinists.

Although it is still difficult to organise, there is cross-border action as well as words. In February dissidents in Poland, Czechoslovakia, Hungary and the Soviet Union staged simultaneous demonstrations against the harshness of life under President Nicolae Ceausescu in Romania (Romanians quip bitterly that they live in "Ceauschwitz"). Demonstrators gathered in front of the Romanian embassies in Budapest and Prague, 60 people went on a 24-hour hunger strike in Prague, and five Soviet dissidents, headed by Mr Andrei Sakharov, signed a statement of support. All this was co-ordinated by activists from Charter 77 in Czechoslovakia, with the help of telephone calls and personal links established over the years. Independent "peace" conferences, attended by people from many countries, were held in Warsaw last spring and Budapest last autumn. More conferences, some on less innocuous-sounding

A chain of change in Gorbachev's empire

FROM A SPECIAL CORRESPONDENT IN EASTERN EUROPE

IN ITS early days, the Polish-Czechoslovak Solidarity society was a small band of adventurers crazy enough to carry rucksacks filled with subversive literature back and forth across the mountains that divide the two countries. Now Polish-Czechoslovak Solidarity operates quite openly, with a monthly newsletter. Its leaders plan conferences and demonstrations, supervise translations, and arrange meetings between opposition leaders at the border. Its more ambitious members hope to expand operations into Hungary, East Germany, even the western republics of the Soviet Union. This is part of a new phenomenon in Eastern Europe. Contacts between dissidents from different countries are steadily deepening and multiplying.

In October 1986, 125 opposition leaders from five Warsaw pact countries signed a joint statement commemorating the 30th anniversary of the Hungarian uprising. Many other joint statements—for example, on the right to conscientious objection—have followed. The cross-border ties go beyond mere communiqués. In all sorts of ways, efforts are being made to overcome

the obstacles that have kept the nations of Eastern Europe even further apart from each other than from Western Europe.

Old resentments are partly responsible for this modern Balkanisation. Czechoslovaks remember that Polish and Hungarian soldiers took part in the Soviet-led invasion which put down the Prague Spring of 1968; Hungarians deplore the treatment of their brother-Hungarians living in Romania and Czechoslovakia; and so on. The practical barriers are also considerable. It is often hard to get a passport for travel from one communist country to another, particularly if you happen to be known for dissenting views. Communist travellers are searched more carefully at each other's borders than westerners. Dissidents' telephone calls are closely monitored.

These difficulties, it seems, are increasingly surmountable. Polish opposition leaders first began to contact dissidents in other communist countries in the 1970s. Czechoslovaks and Hungarians were invited to seminars in Warsaw, where they learnt the mechanics of underground printing. The chief publisher of AB, the largest unofficial print-

Alternatively, in Poland

FROM A SPECIAL CORRESPONDENT IN POLAND

TEAR gas and clubs are all very well for most occasions, but what is a Polish policeman to do when 5,000 students dress in red, wave flags with Bolshevik slogans and gather round the chimpanzee cage at the zoo to sing Stalinist hymns? Since the first such Happening, in 1987, the authorities have been understandably confused by the motives of the Orange Alternative, the youngest and certainly most original group to emerge in Polish politics.

Based in Wrocław, a Solidarity stronghold in south-west Poland, the Orange Alternative has made its name by mocking the issues which government and opposition alike hold sacred. It commemorated the second world war on Polish Remembrance Day by chanting "Molotov—Yes! Ribbentrop—No!" At Christmas it wore Santa Claus suits and carried signs claiming that "Only Santa Claus can save you from poverty," a gibe at the claims of both government and opposition. When the local Solidarity chapter was calling for a boycott against voting in last winter's referendum on reforms, it held a counter-demonstration, calling for Wrocław to become "the city where more than 100% vote."

Although most of the participants in the Orange Alternative's events are teenagers looking for a good time, the roots of the movement lie in the more sophisticated ideas of an elusive art historian

named Waldemar Frydrych, alias "The Major". Never a conformist—he refuses either to bathe or to maintain a permanent address—The Major found himself stranded in post-martial-law Poland, unable to tolerate either official culture or the earnest, quasi-religious Solidarity demonstrations. Determined to create a new form of cultural politics, he printed a manifesto, and announced the birth of Socialist Surrealism (the theory) and of the Orange Alternative (the practice).

Drawing on Dadaism and plain political savvy, he began to organise periodic Happenings—demos which bring out the absurdity of communism in Poland simply by taking it seriously. The group also prints punk parodies and collages of the official press. The point, explains The Major, is "to treat the political system of Poland as a work of art."

The movement appears to be spreading. Poznań, Gdansk and Crakow have already been the sites of Orange-Alternative-style demonstrations. Warsaw remained relatively untouched until Easter Monday, when a group of students had a mock war in the centre of the city's old town. Shouting slogans like "Freedom and Water", those dressed in blue heartily dumped pitchers and buckets of water on those dressed in green, until the police—some catching a few calculated sprays—moved in.

After their early confusion the police have now become involved in Wrocław as well, detaining demonstrators at each Happening. The Major himself was recently released from two months in jail, where he had been sent after a particularly riotous celebration of International Women's Day. "Disturbance of the peace" was the charge levelled at the leader of several men who dressed up as women to celebrate the occasion, and caused a minor riot by dispensing free sanitary towels, of which there is a serious shortage in Poland, in the centre of the city. However, Happenings continued to take place even during The Major's sentence, showing that the movement will not easily be squashed.

While its taste and tactics are not always acceptable to everybody, the Orange Alternative's significance lies in its appeal to a generation which was too young to have been part of Solidarity, and now wants to make a mark of its own. Its members have consciously avoided the mainstream opposition, considering its leaders too old and its methods too ossified. In fact, to a group of young people raised on the legacy of Solidarity's failure, Dadaist anarchism seems more rational than discussing economic reforms which won't work and political change which doesn't happen. Whether their activity could or should turn into something more substantial is a question that will soon face the group's leaders. For the moment, most feel that maintaining a sense of humour is more important.

topics, are planned.

Links between academics are especially important in countries where thought itself is still subject to state control. To counter the difficulty of crossing borders, scholars in Warsaw, Budapest and New York are now simultaneously conducting philosophy seminars on the topic of "Democracy". Each seminar is taped, and a transcript sent to the participants in the other two countries. Universities are also a source of translators. In recent months, more than one obscure professor of comparative literature has suddenly found his services much in demand and his private income rising rapidly.

E pluribus unum?

The Catholic church, both as an institution and as an idea, has long been a channel for exchanges of people and information between communist countries. Poles, Lithuanians and Ukrainians, in particular, have taken a lively interest in each other's ecclesiastical affairs. Now Catholic nationalist groups in Poland that would otherwise ignore the existence of foreign countries have been scrambling to contact the newly vocal

Christian militants in Prague, Brno and Bratislava. Concern about pollution could also become a rallying-point for often disparate dissident groups. One example of sprouting cross-border Greenery is the collaboration between Slovak and Hungarian environmentalists opposed to the damming of the Danube near the border between their two countries.

What comes of these cross-border links will in the end depend upon whether the participants can find a common language. In the literal sense, most can converse in English, French or even Russian. But most of the East European opposition movements spring from different intellectual and political sources. The search is now on for common ground—on the environment, religion, human rights, or on some shared idea of European identity—beyond a common sense of suffering. While it may be early to talk (as some do) about preparing future diplomatic relations in a Central Europe free of Soviet dominance, it is never too soon to start erasing the prejudices that shape the history of this part of Europe.

France

Open and shut

FROM OUR PARIS CORRESPONDENT



Nobody lays down fog better than a French politician. Since May 14th, when the re-elected President Mitterrand called a snap parliamentary election, Socialists and conservatives have been arguing over whether this marked "the end of the opening to the centre".

Grasping what that word-cloud means is not necessary to understanding the row. It is enough to know that centre-right politicians claim to have been had by Mr Mitterrand. He promised and then denied them, they complain, a say in the new government he set up after his victory in the presidential election. Mr Valéry Giscard d'Estaing, a former president and centre-right leader, said on May 17th: "The opening did not take place." Mr Mitterrand has a less final view. He seems to believe the idea of future deals with the centre-right is still alive. Mr Ray-

mond Barre, a defeated presidential candidate and another leader of the centre-right, agrees with him.

Before his re-election, Mr Mitterrand did imply that his next government would not be entirely Socialist, a stretchable promise. He did not want to scare off centre voters who might fear a return to the Socialist policies of 1981-83. He also wanted insurance against a narrow win, which could have obliged him to work around the majority the centre-right and the neo-Gaullists between them had in the old parliament.

But Mr Mitterrand's win was crushing. Centre-right leaders made it known that they would not join a new government under Mr Mitterrand, at least not right away. With 54% of the vote, Mr Mitterrand was given an overwhelming reason to dissolve parliament. Two-thirds of the voters, according to the opinion polls, wanted him to do so at once. Holding off an election until the autumn or longer would have turned the usual rule of "respecting the voters" on its head—and risked losing the Socialists' newfound momentum.

The president's new prime minister, Mr Michel Rocard, has a 26-minister government including 19 Socialists and only a handful of non-Socialist notables, mostly with loose centre-right ties. Mr Pierre Bérégovoy returns to the finance ministry, Mr Pierre Joxe to interior, Mr Roland Dumas to foreign affairs, Mr Jack Lang to culture. For a first government that might well be changed before long, Mr Mitterrand wanted people with experience rather than hyphens linking his centre-left to the right.

He also had to think of his own party. The Socialists were kept in the basement for much of the presidential campaign. Then they had to swallow as prime minister a man most of them had for years treated as a right-wing renegade. They wanted their say in the choice of a new first secretary. Mr Mitterrand's apparent favourite was Mr Laurent Fabius, a former prime minister and gracer of Parisian salons. Yet once it became obvious that most of the party's executive committee preferred Mr Pierre Mauroy, a more working-class ex-prime minister, the president did not stand in the way.



Rocard is all ears

Mr Barre, who seems to recover his lucidity the moment he stops campaigning, summed up the entire row well. France's voters, he said, want effective government. For this, the president needs a majority in the National Assembly. To encourage his centre-right colleagues to stop grumbling about "failed openings", Mr Barre added that he thought the Socialists were almost certain to win the election. The opinion polls seem to agree with him. The two-round election will be held on June 5th and 12th under revived first-past-the-post rules. In the 577-seat assembly, 289 seats are needed for a majority. The Socialists are confident of getting 300 or more.

West Germany The logic of Lambsdorff

FROM OUR BONN CORRESPONDENT

THERE will be those who groan at the prospect, but Mr Helmut Kohl looks set to remain West Germany's chancellor well into the 1990s. That seems odd, just after the mauling of Mr Kohl's Christian Democratic party in the Schleswig-Holstein state election. Odder still, his survival chances soar for an apparently unhelpful reason: the likely resignation of Mr Martin Bangemann as economics minister and chairman of the Free Democratic party, the junior partner in Mr Kohl's centre-right coalition. But consider the logic that leads from a departing Bangemann to an unbudgeable Kohl.

Mr Bangemann is a great gourmet but he has no perceptible appetite for economics and hates the party hackery in Bonn. He took on both jobs under pressure from Mr Hans-Dietrich Genscher, the foreign minister and chief Free Democratic string-puller. Now he wants out. Ideally he would like to become president of the European Commission. Even if the present incumbent, Mr Jacques Delors of France, stays put, Mr Bangemann seems ready to take a lowlier post in the commission. Either way he would start work in Brussels in January.

He coyly refuses to confirm or deny any of this, but his party colleagues are already looking for his successor. They do not have to look far. Count Otto Lambsdorff, himself a former economics minister, stands to win the Free Democratic leadership at the party's congress in October. He has no real rival.

Count Lambsdorff, one of the most eloquent and abrasive of politicians, has been down but not out since resigning as economics minister four years ago in connection with a "political payoffs" scandal. The most serious charge against him, that he was bribed while a minister to give tax breaks to



In for the Count

the Flick industrial group, was dropped in 1986. Last year he was fined for aiding and abetting tax evasion on behalf of his party (hitherto a widespread practice in German politics); but he was not accused of lining his own pockets, and kept his career ticking over. By taking the Free Democrats' leadership, he would complete his comeback.

He would not join the cabinet (the economics ministry might not even survive in its present form), but would concentrate on the party job alone. A hallmark of Mr Kohl's tortuous leadership technique is that policy decisions tend to be taken by small groups outside cabinet sessions, miffing ministers but leaving them helpless. Count Lambsdorff got wise to this tactic when a minister himself. This time he is aiming where the real power lies. He would be a more uncomfortable partner for Mr Kohl than Mr Bangemann ever was, and some Bonn-watchers reckon the extra friction would split the sorely strained coalition. The opposite is more likely.

One reason is that, unlike many people, Count Lambsdorff does not underestimate Mr Kohl. He may not think much of the chancellor's grasp of economics. Few do. But he has a healthy respect for his political nous.

More important, it was Count Lambsdorff even more than Mr Genscher who in 1982 drove the Free Democrats to break away from the centre-left coalition led by Mr Helmut Schmidt's Social Democrats, and into alliance with Mr Kohl. He did so because he reckoned the West German economy needed a shake-up which a Social Democratic-dominated government could not produce. His view has not changed even though the performance of the present coalition, so far, has fallen well short of his hopes. He wants to kick the government to success, not pull the rug from under it.

That leaves the Social Democrats out on

their own. Hardly anybody believes that they could win an absolute majority in the election due in 1990. At present the opinion polls give them around 40% of the national vote. The squabbling Greens look less of a possible coalition partner for the Social Democrats than they once did. A Free Democratic party under Mr Bangemann might

conceivably have been tempted back to a centre-left alliance in 1990; under Count Lambsdorff definitely not. Small wonder that Mr Hans-Jochen Vogel, the Social Democratic leader, has been demanding that Mr Bangemann be stopped from going to Brussels, arguing that "better candidates" for the commission should be found.

Soviet Union

Counting the *das* and the *nyets*

A Soviet leader today is powerful, but not all-powerful. That is abundantly clear as Mr Mikhail Gorbachev struggles to swing Communists behind his reforms in the run-up to next month's special party conference. He has to reckon with the clout of colleagues at the top and with the concerns of comrades at the grassroots. In the first of two articles, a special correspondent looks at the people who matter most after Mr Gorbachev

EVEN in these days of *glasnost*, remarkably little is known about the power game in the Kremlin. Sovietologists were all agog when the Kremlin's second-in-command, Mr Yegor Ligachev, let slip to *Le Monde* that he, not Mr Gorbachev, chaired meetings of the Communist party's influential Secretariat. Their ears pricked up again when Mr Lev Zaikov, the Moscow party boss and overseer of the defence industries, told *Newsweek* that he was number three in the Kremlin's pecking order. Who are the next-to-top Communists, and to what extent are they friends or foes of Mr Gorbachev?

The most powerful people in the Soviet Communist party are those with a seat both in the Politburo, which takes the big decisions, and the Secretariat, which runs day-to-day business. There are now six of these supercomrades. In addition to Mr Ligachev, Mr Zaikov and Mr Gorbachev himself, they are Mr Alexander Yakovlev, who shares Mr Ligachev's responsibility for ideology and propaganda; Mr Nikolai Slyunkov, who supervises the economy; and Mr Viktor Nikonov, the man with an eye on the farms.

When it comes to *glasnost*, Mr Gorbachev's campaign for franker reporting and more open discussion, Mr Ligachev and Mr Yakovlev represent, respectively, the conservative and reformist poles in the leadership. A struggle has developed between the two men and the ideas they represent.

Mr Ligachev not only chairs the Secretariat and oversees the day-to-day running of the party machine, he is also in charge of personnel policy and relations with other communist countries and the third world. Some reports have it that Mr Yakovlev has wrested from him

responsibility for culture, propaganda and the press, although this has been denied.

Mr Ligachev agrees that some sort of economic reform is essential. But he is far more cautious than Mr Gorbachev about how far and how fast it should go. He has given warning of the danger of upheavals like those in Poland if food prices rise, factories go bankrupt and workers lose their jobs. He dismisses "market socialism" and dislikes the extension of private enterprise. He abhors Mr Gorbachev's pet concept of "socialist pluralism" and worries that *glasnost*, and especially the revelations about the horrors of the Stalin era, could destroy ordinary people's faith in communism and the party.

Mr Ligachev, 67 to Mr Gorbachev's 57, has a reputation as a stern disciplinarian, a devoted family man, and something of a puritan in his private life. It is said that he will promote nobody he believes to be a bad father, on the argument that anybody who cannot bring up his children properly is unworthy of being a party official. A confirmed teetotaler, he is said to be the driving force behind the campaign against alcoholism. But he may not be the dry, unbending stick he is sometimes made out to be. He is said to love historical studies and works by Siberian writers. And he has masterminded some pragmatic-sounding educational reforms.



Plump and sleek, the 64-year-old **Mr Yakovlev** could not be more of a contrast. He is the architect of the current cultural liberalisation. Unlike Mr Ligachev, who spent long years as party boss in an industrial region of Siberia, Mr Yakovlev spent a year in New York as an exchange student at Columbia University. After getting into hot water in the early 1970s for criticising Russian nationalism, he spent ten years in "ex-

ile" as Soviet ambassador to Canada.

Familiarity with the West has bred contempt. He is fiercely anti-American and favours expanding ties with Western Europe and Japan. Yet, although he despises "western mass culture", he also shows little of Mr Ligachev's alarm lest *glasnost* slip into "anarchy". Mr Ligachev would like to see rock music banned. Mr Yakovlev demurs, saying "I personally don't like rock and roll, but if my grandchildren like it, let them." It is on the Yakovlevs and the Gorbachevs, not on Mr Ligachev, that Soviet intellectuals are pinning their hopes for a freer society.



Kremlin-watchers used to assume that the 65-year-old **Mr Zaikov** was firmly in the Gorbachev camp, but now some are not so sure. A one-time metalworker and a qualified engineer, he spent 35 years in the defence industry in Leningrad. An efficient and self-confident manager, he was made Leningrad party boss in 1983, before Mr Gorbachev brought him to Moscow to supervise the defence industry. Although he now runs Moscow, too, he has kept his seat in the Secretariat.

The other two super-secretaries, **Messrs Slyunkov and Nikonov**, both 59, are promoters of *perestroika*, the "restructuring" of the Soviet economy. Mr Slyunkov's job is to oversee these economic reforms. When he was party leader in Byelorussia in the mid-1980s, his republic tried out a number of the economic experiments which have since spread through Soviet industry. Mr Nikonov's agriculture job used to be the Politburo's ejector seat (until Mr Gorbachev turned it into a launchpad for his own career).



Born, like his boss, into a Russian peasant family, Mr Nikonov shares Mr Gorbachev's belief that less central control is essential to getting more food out of Soviet farms. And a better food supply is one of the few ways of persuading the Russian-in-the-queue that *perestroika* is worth working for.

War and peace
If Mr Ligachev were the only top comrade Mr Gorbachev had to worry about, the run-up to next month's party conference would not have been so full of semi-open strife. The split at the top of the party runs deeper. Word has it that the "conservative manifesto" which appeared in the form of a letter in *Sovietskaya Rossia* in March had the backing not only of Mr Ligachev but also of Mr Zaikov and at least three other Politburo

War and peace

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members: Mr Viktor Chebrikov, the KGB's boss, Mr Mikhail Solomentsev, who owed his promotion under Andropov to his belief in discipline rather than in radical reform, and President Andrei Gromyko.

For the moment, the Gorbachev and Ligachev camps have backed down from a face-to-face confrontation. A reconciliation is being attempted for the party conference. Sooner or later, heads must surely roll. The question is, whose?

Spain

Class politics

FROM OUR SPAIN CORRESPONDENT

WHICHEVER way he looks, nobody seems to feel much love these days for Spain's education minister, Mr José Maria Maravall. On May 16th, after two months of intermittent strikes in state schools, more than 70% of the country's teachers voted to reject his offer of a 5% pay increase. With no

end in sight to the strikes, the parents' associations are accusing Mr Maravall—not the teachers—of inflexibility. Other ministers are worrying about the impact of the disruption on the Socialist government's popularity rating, which has fallen to its lowest point since 1982.

The teachers' somewhat chaotic eruption comes after years of frustration. Teachers grumble that they work harder and earn less than other civil servants with similar qualifications. Ministry officials point out that, with monthly salaries ranging from Ptas110,000 to Ptas180,000 (\$950 to \$1,600), they are better off than their colleagues in private schools, who generally work longer hours.

Although the increase Mr Maravall is offering is only a third of what the strikers are demanding, he has proved flexible on other issues. He is willing to discuss demands for more training, more sabbatical leaves and less geographical arbitrariness in postings. But he has so far refused to consider shortening the 30-hour working week, of which five to 12 hours may be taken up

with non-academic duties.

This week's vote has embarrassed the four unions which had signed a preliminary agreement with the education authorities. End-of-year exams are approaching and uncertainty is growing in staffrooms over what to do next. Mr Maravall's threat to lengthen the school year has achieved little besides enraging teachers and upsetting parents who have already made plans for the summer holidays.

Meanwhile, headmasters of private schools, which about a third of all pupils attend, are gleefully reporting an increase in registrations for the coming academic year. Private-school teachers are feeling smug too. They have been dutifully turning up for work. On May 17th the federation of private-school owners rewarded them with pay increases of 17% and more, a shorter working week and sabbatical leaves for some. All this brings their working conditions much nearer those of their state-school colleagues, who could take lessons from them in the art of peaceful wage bargaining.

Europe sans horaires

CAN Europe have a single market before it has a single lunchtime? Europeans' determination to have lunch at three o'clock (Spain) or 12 o'clock (West Germany) or one o'clock (Britain) means that catching a European businessman at his desk is often guesswork. Lunch is only part of the problem. In Greece, nobody makes telephone calls between two and five, because everybody is having a snooze. So how can Greeks do business with West Germans, who start going home at four? They need to ring in the morning.

The problems are just as bad in European countries outside the EEC. Norwegians get to the office at eight and leave for lunch at 11. They have dinner as early as five o'clock. Visitors are often left mystified, and hungry, when they try to go out to dinner at nine: the restaurants are getting ready to shut. The Swiss start disarmingly early too. Zurich bankers have been known to make appointments for seven in the morning. And the visitor is expected to arrive five minutes early (except in Lausanne, where being 15 minutes late is a decadent French-Swiss tradition).

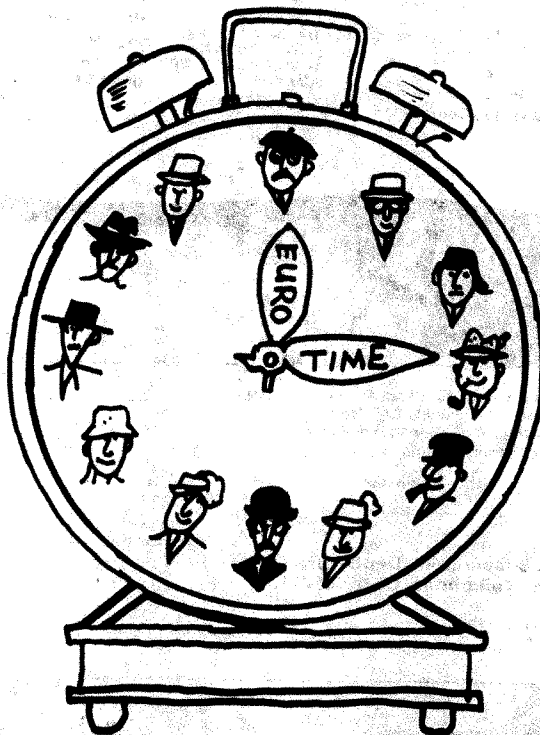
The British tend to arrive at their desks at 9.30, but do not like to be rung on the telephone at that hour. They do paperwork and drink coffee while collecting them-

selves. They can rarely be reached after 5.30, even if they are at their desks: British switchboards close down. Europeans have to remember to ask British businessmen if they have a direct line for after-hours calls. The French, like the Germans, start earlier than the British, and occasionally show off with a working breakfast.

Vanishing civil servants are a problem in Italy, where they work from eight to two and then go home (though they work a six-day week). The visitor is advised to make all telephone calls in the morning. Most attempts to reach people in the afternoon seem to fail.

Theories about national hours and national character are risky. The Levantine Turks keep hours rather like the British. The Irish (who used to say that when God made time he made plenty of it) have produced a new breed of businessman who prides himself on taking telephone calls from Hongkong at four o'clock in the morning.

The strength of timekeeping tradition is being tested in Greece. In February the government declared that the three-hour lunch and subsequent pause must go. Thirty-minute snacks are the order. The move is part of the government's attempt to lessen air-pollution in Athens: short lunches mean that few people bother to go home to eat, so the hope is that Athens will now have only two rush hours a day instead of four. The problem of afternoon heat in summer may scotch that. For the moment, the change presents other problems. The three-hour break was the honoured time for extramarital assignations.



The Economist

A SURVEY OF SOUTH KOREA

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SOUTH KOREA



Foursquare to the future

SOUTH Koreans are savouring something new. Throughout history, their peninsula has fallen under the suzerainty of others: Chinese; Japanese; Americans; Russians; their own military. Now ordinary South Koreans hold their destiny in their own hands as never before. A booming, liberalising economy has created an independent-minded and extraordinarily well-educated middle class. A parliament which will no longer be a rubber stamp should curb a government which has always been inclined to be authoritarian.

Less than a year ago, comparisons between South Korea and the Philippines at the time of the fall of ex-President Ferdinand Marcos were in the air. No more. Then President Chun Doo Hwan, who had run South Korea with ramrod sternness for the previous eight years, had hand-picked his chum and fellow former general, Mr Roh Tae Woo, as his successor. Few would have predicted the political imagination and astuteness displayed by Mr Roh in coming to terms with the demands of ordinary South Koreans for more democracy to match their greater prosperity. President Roh is the first ruler of South Korea to have come to power the democratic way.

Mr Chun did not enjoy the mandate of legitimacy that can make a leader, however stern, acceptable to his people. He took power in a coup following the assassination in 1979 of his predecessor (another power-seizing general). When he tried to pass on that illegitimacy through a hand-picked suc-

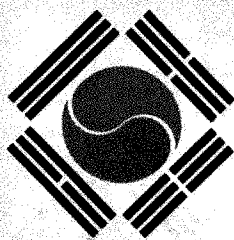
cessor, bankers and businessmen made common cause with radical students, taking to the streets in their lunch-hours, shouting "down with the dictator" through clouds of tear gas. They simply would not have Mr Roh foisted on them.

It was then, on June 29 1987, that Mr Roh promised an eight-point plan of political reform, including a direct election for the job he was to take. South Koreans gave him the nod of legitimacy at the polls on December 16th, but gave him only 36% of the vote to remind him that it was a qualified nod—a point that they sharply reiterated when they removed his governing Democratic Justice party's overall majority in April's National Assembly elections. Now Mr Roh has to live up to his promises. So far, he has done little one way or the other.

The political and economic gains could still be lost. They are recent, fragile and reversible. Mr Roh now sounds the born-again democrat, but few South Koreans are yet convinced. South Korea's economy is still acutely vulnerable to external shocks. American complaints about its trade surplus ignore the fact that, until 1986, South Korea ran a persistent and troubling deficit. Another oil crisis, a rise in world interest rates, or recession in its main export market, America, could all make Mr Roh question how democratic he can afford to be. But with every day that passes, the possibility of his retreating into the old ways—or being pushed aside—becomes more remote.

The country that Mr Roh has taken over is dif-

September's Olympic games in Seoul mark South Korea's coming of age. Christopher Lockwood, our East Asia correspondent, wonders with how much confidence the economic prodigy can look forward to adulthood



ferent from the sickly-looking republic that held its first election and set out for independence 40 years ago. Thirty-five years of Japanese colonial rule had left little permanent behind to sustain the country. Its young men and women had been deported to serve Japan's war machine. The north of the country had what industry was left at the end of the second world war, and that had fallen under Russian control. Three-quarters of South Korea's citizens were impoverished farmers. Two years later one of history's bloodiest civil wars erupted: it left 1m Koreans dead after three years of conflict. South and North Korea still confront each other warily across the demilitarised zone (DMZ).

The economic turnaround since the fighting stopped has been a text-book example of development. In real terms national income has expanded by 1,200% since 1953. South Korea is now the 17th largest economy in the non-communist world and the 12th largest trading nation. This prosperity has given the average South Korean nearly 20 years longer to live; only one child in 32 dies within a year of birth instead of one in 15; only three or four people in every 100 do not learn to read and write instead of 80 or more; and nobody starves to death.

Middle-class indicators like the number of telephones and televisions may seem trivial: but they give people a stake in stability. As late as 1970 only 2% of households had refrigerators, 4% telephones and 6% televisions. Now, there are fridges in three-quarters of the houses, telephones in half of them and televisions in virtually all of them. Women appear to have done all their laundry by hand in 1970; now 25% of homes have washing machines—still 100% fed by women, however. Six times as many houses have pianos as they did, and it is said that in

Seoul nine schoolchildren in every ten play musical instruments. Only 40% of household income now needs to be spent on food. Last year the economy's exports rose 36%; real growth was 12%; and unemployment stayed low at 2.2%.

Justifiably, South Koreans are proud of themselves. They are proud, too, that the world will be beating a path to their door for September's Olympic games. Unless North Korea does something to sabotage them (which is always a possibility: American battleships will be in the area just in case), they should be the most widely supported games in history. Russia, China and the United States will compete against each other for the first time in 32 years.

But Koreans are not in the habit of patting themselves on the back. They move on. South Korean industry displays a swashbuckling confidence. The tallest building in Asia? Up goes the Daihan Life Insurance building on Seoul's riverfront, and no matter if it is half-empty. Heavy industry? South Korea possesses the world's largest steel plant and its largest dry dock. It builds its own fighter aircraft. 256k-DRAM memory chips? Here. Wait a few more months and you can have megabit DRAMs, too. A car perhaps? South Korea produced 800,000 last year—eight times more than in 1982—and exported two-thirds of them. Output will rise another 50% this year. Biotechnology, superconductivity, artificial intelligence, liver transplants and space rockets? All are on the way.

Koreans have always been a creative and imaginative lot. Admiral Yi, their sixteenth-century naval hero whose statue looks down on Seoul's main thoroughfare, devised the world's first ironclad warship to defeat the invading Japanese. Koreans were using movable metal type two centuries before Gutenberg. South Koreans may have dispensed with the traditional *hanbok* and moved into business suits, but they still feast morning, noon and night on *kimchi*, a dish of fermented cabbage, garlic, and laser-hot peppers unlike anything else in the world. Running such a hot-breathed and frankly nationalistic country has problems all of its own. Mr Roh has kindled expectations that he must now strive to live up to.

If he wishes to be remembered as one of Korea's great leaders, Mr Roh has to juggle with four skittles for the next five years:

- He must fulfil the promises of democracy he made last June. It ought to seem at least conceivable that political power could be transferred peacefully to the opposition. He can achieve this by dealing constructively with a parliament in which he no longer controls an overall majority.
- He must keep the economy growing as fast as people have come to expect. That means threading a difficult course between inflation, America and Japan. Growth of 7% a year is needed to accommodate a population boom if unemployment is not to rise or living conditions to fall.
- He must distribute the fruits of economic development more widely. Some South Koreans are coming to feel that social development has been a casualty of the dash for a bigger GNP.
- Hardest of all, he must try to reduce the tension between South Korea and North Korea, which is still the most painful fact of Korean life.



Cannon to the north of them

PANMUNJOM is the world's weirdest tourist spot. A tiny village on the 38th north parallel, it straddles the Military Demarcation Line which runs through the centre of the DMZ dividing Korea. Each year 75,000 visitors peep into North Korea from the raised Freedom Pagoda south of the line. They are escorted into the Military Armistice Commission (MAC) building in which a halt to the Korean war was called in 1953. The line runs through the MAC building, so they can step over into North Korea to be stared at by North Korean soldiers peering through the windows.

They may observe the flags on the conference table: the United Nations flag has a larger spike on top, but the North Korean flag retaliates with a more complicated base. Such is the pedantry of diplomatic point scoring. Visitors can approach, but not set foot on, the Bridge of No Return, across which tens of thousands of prisoners were exchanged at the end of hostilities. They can enjoy the tranquility of the almost uninhabited DMZ. It is four kilometres wide and 240 kilometres long. If they are lucky, they may see Manchurian cranes. Even a Korean tiger, symbol of the Olympic games but an animal extinct in the South, is said to have been spotted. (It was probably a wildcat or a striped Korean bear.) The near deserted DMZ has become an undisturbed sanctuary for wildlife.

Undisturbed, that is, apart from noise. Night and day, loudspeakers on both sides boom speeches and stirring music. Far from being a museum, Panmunjom is the one place where South uneasily meets North. It is where tiny concessions—cruelly brief family visits or the repatriation of soldierly remains—are occasionally negotiated.

The armistice of 1953 was meant to last for a matter of months until a peace, rather than a ceasefire, could be negotiated. But the armistice commission has been meeting at Panmunjom roughly once a month for the past 35 years while the Koreans have remained, technically, at war.

Its meetings are a forum for the exchange of vituperative accusations and counter-accusations in English, Chinese and Korean. There has been no lasting improvement in North-South relations since 1953. All those long years of diplomacy have failed to produce postal, telephonic or visiting links between the two parts of one of the world's most ethnically and historically homogeneous nations. South Korea's government warns constantly of the threat from the North, as if an invasion were coming any day. At the moment, the prospects for any improvement of relations, whether military, economic or diplomatic, seem as poor as ever.

The reunification of Korea is the constitutionally avowed goal of both countries. South Korea's population of 42m includes 10m people with close relatives on the other side of the DMZ. The South's national anthem invokes holy Mount Paektu, now in the North and inaccessible to South Koreans who must make do with Mount Sorak instead. North Korea has repeatedly refused to have both countries admitted into the United Nations on the

ground that to do so would institutionalise a temporary division. But though everyone pays lip-service to it, nobody talks seriously about reunification.

North Korea is what the whole of Korea was once known as—the Hermit Kingdom. It is probably the world's most closed society, and its most orthodox practitioner of Stalinism. Mr Kim Il Sung, the Great Leader, has presided over North Korea since 1946, and the eventual accession of the Dear Leader (his son, Mr Kim Jong Il, who is said to receive James Bond movies by diplomatic bag) is, despite rumours of opposition, highly probable.

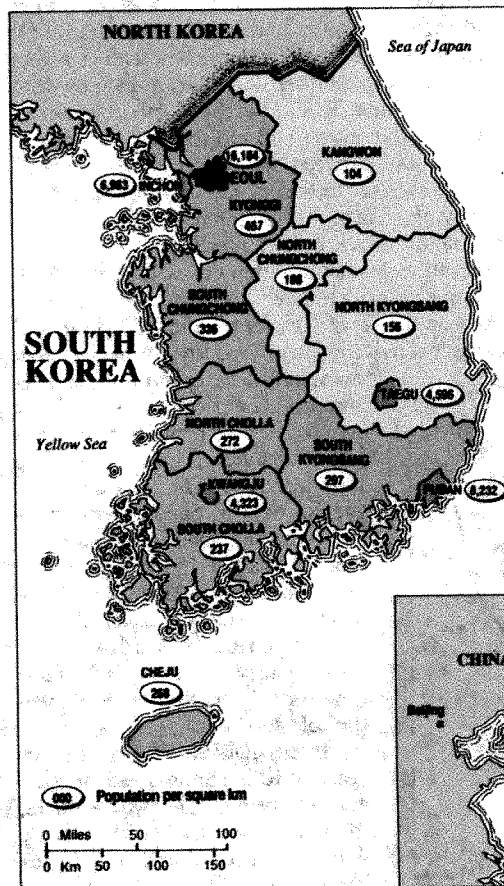
In North Korea the state owns not just the means of production, but everything: there are no private bicycles, let alone cars. Nobody on either side has even begun to contemplate how such a state could be married to the South's dynamic, largely privately owned, economy. The best that can be hoped for is a few cultural, humanitarian and economic exchanges and the avoidance of war.

Prepared for the inconceivable

Another war is almost beyond imagination, but both sides are well prepared for one. South Korea devotes a high 6% of its GNP to defence, the North a bankrupting 20-25%. Two-thirds of both armies are said to be deployed within 60 miles of the DMZ, though there is not much that South Korea can do about the vulnerability of Seoul to attack: the city of

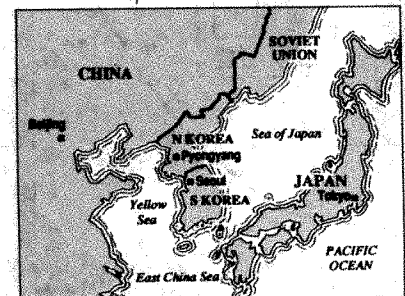


Making friends with the North's friends is the South's best defence



Population of selected countries per square km

China	110
Japan	325
North Korea	175
South Korea	425
Taiwan	560
United States	25





10m is only 25 miles as a MIG fighter or a SCUD missile flies from the DMZ. Both sides enjoy access to the near-best in military technology, though up to now Russia has denied North Korea its top-of-the-line MIG-25s.

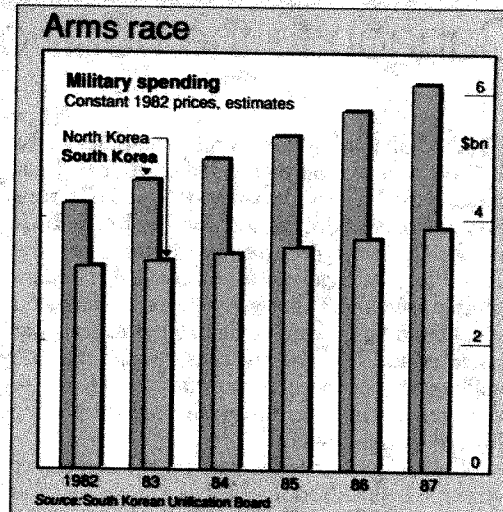
South Korea is militarily weaker than the North. Its army is smaller (630,000 men, against 830,000). It has half as many tanks, as well as fewer aircraft and guns. But its equipment is better maintained than the North's, and its more successful economy is eroding the difference fast: it is now in the third stage of a military-modernisation programme. America is pledged to defend South Korea, and American troops are stationed on its soil.

North Korea, by contrast, is up against the ropes. That might make it dangerous. It has never been so isolated, nor so galled by the economic success of the South, to say nothing of Seoul's accolade of the Olympic games and Pyongyang's failure to become "joint host" to them. Estimates of North Korea's GNP are deeply unreliable (its scanty official figures do not include services in calculating "gross social product"): but the South's real income is thought to be between two and three times as much per head as in the North, making the country perhaps five times richer.

More important, South Korea is creditworthy: despite being, earlier in the decade, the world's fourth and Asia's most indebted nation, it has never defaulted. North Korea has a reputation for not meeting its obligations. A recent credit rating of 112 countries drawn up by *Institutional Investor*, a financial magazine, placed North Korea 112th. Though it is richer in natural resources than the South (so that until the mid-1960s it was richer per head than the South, and is still richer than most Asian countries), bad management and a severe shortage of capital have slowed down its growth to next to nothing. So short is the North of non-military assets that it uses tanks to compact its roads.

Relations between South and North Korea go through cycles of frostiness. Just as things seem to be improving, North Korea commits an atrocity: a commando attack on the president's residence in 1968; an assassination attempt on President Park Chung Hee (which killed his wife) in 1974; an attempt on the life of President Chun Doo Hwan and his cabinet in Rangoon in 1983 (the former escaped: many of the latter did not); the destruction of Korean Air's flight number 858 over the Andaman Sea last November. The effect of this most recent outrage, as hardliners in the North who oppose better relations with the South presumably intended, has been to stall all diplomatic contacts. American diplomats, who had been given the go-ahead to chat to North Koreans at third-country cocktail-parties, have now been instructed to give them the cold shoulder.

In his new year's message this year, Mr Kim Il Sung called for bilateral talks between the two countries, though the offer came with so many strings attached that South Korea has ignored it. Even so, the offer was



a mark of progress. At one time, the North would offer to meet only Americans, whom it considers to be the true rulers of the South ("us imperialists-and-the-South-Korean-puppet-military-fascist-clique" is a pet phrase of Radio Pyongyang's); it later insisted on trilateral talks.

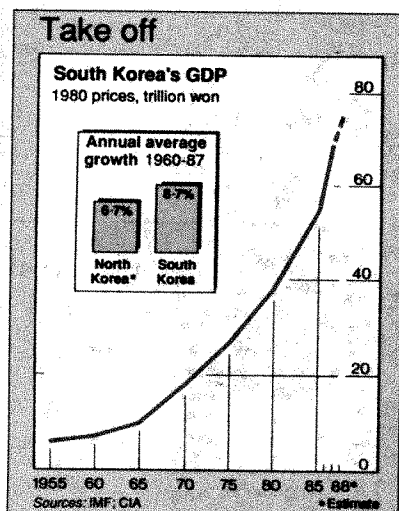
The South Korean government will probably never allow America to be a party to such talks. It would mean admitting that America has a more than purely supportive role in the South. The sad truth is that both sides fear that they have more to lose than to gain in the propaganda war from sitting down together: when, in the past, economic meetings have been arranged, they have made no progress. Mr Roh has said that he is keen to get diplomacy moving again, and has proposed a summit meeting with the 85-year-old Mr Kim Il Sung. It would probably not achieve much, but it would be statesmanlike of Mr Roh to make almost any concessions to get one. In the past the North has claimed, with a degree of reason, that South Korea's presidents have lacked legitimacy. That excuse will not carry much weight in the case of Mr Roh.

Great power play

The daily verbal battles between Seoul and Pyongyang would be just a curiosity were it not that the world's four great powers converge on Korea. South Korea is an excellent ally to America (and so to Japan, which would have more to lose than any other country if East Asia were to become destabilised). True to Mr Kim Il Sung's doctrine of *juche*, or self-reliance, North Korea has become adept at playing off Russian and Chinese interests against each other without giving much away. That is how its army remains well equipped and its economy manages, just about, to stagger on.

America realised the strategic importance of Korea late in the day. Only after Russia had started moving south at the end of the second world war did the undesirable aspects of the Russian presence assert themselves and America moved to protect the southern half of the peninsula.

Russia has no year-round access of its own to the Pacific. Vladivostok, its southerly Pacific port, is blocked by ice for four months of the year. In return for MIG-23 fighters and much other hardware, North Korea has allowed Russia to use its ports



(though not to maintain naval bases). It has also given Russian aircraft overflight rights, which lets them reach Da Nang and Cam Ranh Bay, two big bases in Vietnam, with less chance of being detected. Naturally, Russia's influence in North Korea worries China, which fears encirclement. All China's other borders (with Burma, Vietnam, India and Russia itself) are causes for concern. So China, too, woos the North Koreans assiduously.

Though North Korea has kept out alien troops, South Korea has not. Undeniably, the presence of 40,000 American troops in the South is an obstacle to better North-South relations. Eventually, they will have to go. But when? For the South Koreans, the American forces are an insurance policy. The troops are mostly stationed hard up against the DMZ, near Panmunjom. A North Korean invading force would have little chance but to engage them, bringing America into the war.

For the Americans, too, the arrangement has advantages. The soldiers and their hardware are deployed in a strategically important location, at a greatly subsidised cost. (It is estimated that South Korea subsidises America's rent-free bases to the tune of \$1.5 billion a year, more than the \$1 billion or so that they cost America.) Besides South Korea, America's only Asian bases are in Japan and the Philippines, which is threatening to raise the rent fivefold. South Korea is also the site for the most comprehensive war-games America undertakes. The annual Team Spirit exercises involve 200,000 men and last more than a month.

South Korea's pride will not let it shelter under the American umbrella for ever. It galls young South Korean recruits (three years of national service is compulsory) to be under foreign command. The highest-ranking American soldier in South Korea, General Louis Menetrey, is also the commander of the Korea-US Combined Forces Command,

which encompasses most South Korean units.

There is talk that an American withdrawal might begin as early as 1992. Plenty of people, especially younger South Koreans, would like it to be sooner. America's support for authoritarian president after president does not please those who have braved the riot police in the name of democracy, and have no memories of when America stood by South Korea's side during the Korean war.

During the next five to ten years South Korea will take defence and foreign policy more into its own hands. Mr Roh says he wants South Korea to be militarily self-sufficient by the mid-1990s. That will mean buying a lot more equipment and, in particular, taking control of battlefield communications away from the Americans. One well qualified observer thinks that America has deliberately kept the South Korean army in a state of technological inexperience in order to prolong its stay.

More important for its own security, South Korea is forging better links with the countries which prop up its enemy. Its biggest advantage is simply that it is a more attractive business partner. North Korea has nothing much to offer but coal, iron and concrete, none of which its trading partners lack. Barren South Korea is a consumer of raw materials. It has cheap manufactured goods to sell and, these days, technology to transfer. Direct trade between South Korea and communist countries is prohibited, but indirect trade, through Hongkong or Japan, is booming. There is good reason to expect that direct trade will open up too.

Hungary and Poland already have trade missions in Seoul: Yugoslavia and East Germany will open theirs by the end of this year. South Korea does \$300m-worth of trade a year with Eastern Europe, and could do a lot more. The big prize would be China. Trade between the two countries is estimated at \$2 billion-3 billion a year already, mostly



Tourist attraction



via Hongkong. However, Chinese ships are said to have docked at Inchon surreptitiously to take on board containers labelled "Shanghai". One of Mr Roh's close advisers has in the past year twice visited China unofficially.

Rumours fly about that China may open a trade mission in Seoul after the Olympic games. That, however, will depend in part on the reaction of North Korea. Much though China wants South Korean technology and machinery (which is cheaper than Japan's), it has to guard its flank. Mr Li Peng, China's new prime minister, has plans for an early trip to Pyongyang, and talk earlier this year of a visit by Mr Roh to Beijing met with Chinese silence.

The surest sign that South Korea is succeeding in its quest for better relations with its adversary's friends is that both China and Russia are attending the Olympic games. They open on September 17th in Seoul, and flags and scoreboards counting down the days are visible everywhere. Neither giant has

displayed much solidarity with North Korea's quest to be co-host to the games, or much support for their supposed ally's boycott of them.

Both Russia and China are probably fed up with the North: Mr Kim Il Sung's violent, preperestroika economy which, after Israel, has the highest ratio of soldiers to civilians in the world, is no advertisement for the communist way of life. Mr Ha Yon Chol, who teaches politics at Seoul National University, notes that North Korea does not merit a mention in the foreign-policy chapter of Mr Mikhail Gorbachev's new bestseller. Russian and Chinese athletes and academics have taken to visiting South Korea, though only for multinational events or symposia. Earlier this year a Russian military attaché turned up at a South Korean embassy reception in Tokyo. Since security is the precondition for democratic reform at home, those who want democracy would do well to give the visiting communists a warm welcome in September.

Plures ex uno

President Roh needs opposing

ON APRIL 26th, the electorate threw South Korean politics into considerable confusion. It denied, for the first time, in the Republic's peacetime history, the ruling party an overall majority of the National Assembly's seats. Since the new constitution has clipped the president's power and enhanced that of the assembly, the result is a wholly new challenge to monolithic government. This deserves a welcome, for South Korea has always been short on pluralism. In place of a tradition of democracy, there has been a tradition of rule by strongmen. The political opposition has always been factional, without any unity of ideology or purpose. Splitting its votes in election after election, it has consistently allowed the authoritarians to retain power.

The latest election has not changed the factional nature of politics. The four main parties all derive the great bulk of their support from their leaders' home provinces. But the quirks of the electoral system have given to Mr Kim Jong Pil, who leads the smallest of them, the balance of power between the government and the main opposition parties. A former prime minister, he will not allow Mr Roh's government to fall apart, even though the previous government, of which Mr Roh was a prom-

inent member, once threw him into jail and confiscated his property. But at the moment he stands ready to push for reform should Mr Roh continue to prove dilatory.

South Korea has had only three presidents before Mr Roh, not counting two short-lived stopgaps. Denied a proper opposition, they extended their authority to cover most aspects of life. South Koreans live under many restrictions. They may not print and distribute a newspaper at will: nor do they yet dare to say what they think in the existing newspapers. They may not, on pain of imprisonment, read or circulate material which paints a favourable picture of North Korea: a "pro-Pyongyang youth ring" was rounded up in March.

Despite an amnesty to celebrate Mr Roh's inauguration in February, between 500 and 2,000 political prisoners still languish in South Korea's jails. People are not free to travel abroad unless they are over 40 years old. Students may hold demonstrations on campus, as long as the gatherings do not get too big. Should they venture beyond the gates, they will be driven back by armoured riot police firing rounds of a particularly nasty tear gas.

It is Mr Roh's task, prodded, as he will be, by the opposition, to reverse centuries of bossiness. He



Ready for action



In opposition: Kim Jong Pil, Kim Dae Jung and Kim Young Sam

has repeatedly promised reform. But his background does not inspire confidence in everyone. He fought in Vietnam, became a four-star general, played a key role in the coup in 1979 that installed his predecessor Mr Chun and acted as Mr Chun's right hand for the next eight years. Since Mr Roh took over, South Korea's press—with official acquiescence—has started to describe those years as a corrupt dictatorship. Few discuss the present president's part in them, but it is noted that he was the man running the powerful Defence Security Command in 1980, when army and police killed 200 or more demonstrators in south-western Kwangju.

The middle class still seems prepared to give Mr Roh a chance. Demonstrations against his allegedly fraudulent victory last December failed to gather support, unlike the demonstrations in June which succeeded in overturning Mr Chun's decision to have his successor chosen without benefit of a direct ballot. Mr Roh was the man who talked the uncompromising Mr Chun around. He also secured the release of political prisoners, including Mr Kim Dae Jung, the feistiest of the opposition's leaders.

Mr Roh has made a good first impression. He refuses to be called "Your Excellency", has dispensed with the throne favoured by Mr Chun at cabinet meetings, has cut down on his own security, and has opened up the road outside his residence, the Blue House (though only to pedestrians, who must stick to the far side). Mr Chun's presidency was disliked as much because of his lecturing, unsmiling demeanour as because of specific acts of authoritarianism. Mr Roh smiles broadly at everyone, and declares that men were given two ears and one mouth so that they could listen twice as much as they speak. The national press echoes his favourite theme: that he is an ordinary man in a new era of ordinary men.

Fewer go bump in the night

In many little ways South Korea is becoming a more liberal place. The press writes more freely than it did, but it is still short on opinionated criticism of the present administration. References to imprisoned dissidents such as the much-tortured Mr Kim Kun Tae tend to get edited out. The press is, however, having a field-day with the previous administration: every day brings another allegation about the misdeeds of Mr Chun's younger brother, Mr

Chun Kyung Hwan, who ran South Korea's rural-development agency and is accused of milking it of millions of dollars during most of his brother's presidency. Even the ex-president and his strong-willed and well-connected wife, who was linked to a banking scandal while her husband was in office, are coming under attack.

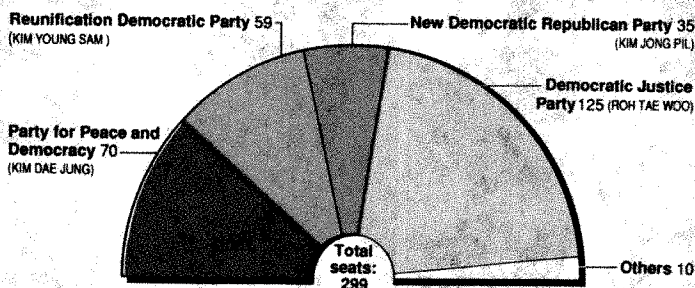
Books circulate more freely too. Students at Seoul National University say they can get hold of pirated editions of Marx. A course on Hegel and Marx is on offer to graduates. Video recordings and grisly picture-books of the Kwangju massacre circulate, as does "people's art" depicting riot police beating up civilians. But they circulate underground. Photo-journalists are still required to submit copies of their work to the Ministry of Information and Culture before it can leave the country; but the rule is not vigorously enforced. Books once had to be submitted to the ministry before publication; that rule has gone.

Even South Korea's vast internal security establishment seems to be lying low, though it is always hard to know what the Agency for National Security Planning (ANSP, the new acronym for the Korean CIA), is up to, or even how big it is. Everyone operates on the assumption that his telephone is tapped, though South Koreans no longer worry about being taken away in the night. Quite how much control Mr Roh has over the agency or over the ultra-hardline Defence Security Command is unclear. A police force of 120,000 needs watching too. Buses full of Darth Vader look-alikes are intimidatingly present on too many street corners. An end to the police state is promised, but cynicism greeted the recent decision to give a suspended sentence to a police chief whose men had drowned a student while they were interrogating him last year.

Mr Roh has moved fast to assert his authority, though it is still not clear what he will do with it. At first there were suspicions that Mr Chun would be the power behind the throne. Shortly before stepping down, Mr Chun reshuffled the top command of the army, supposedly without consulting Mr Roh. But Mr Roh has secured the resignation of Mr Chun from his job as chairman of an advisory Council of Elder Statesmen. The April election defeat has given him the opportunity to shake up the cabinet and the party hierarchy. Some of Mr Chun's closest supporters, including a brother-in-



The new order

Seats in the National Assembly after April 1988 elections
(Party leaders in brackets)

Korea's ballots

	April parliamentary election turnout 73%	December presidential election turnout 82%
	Share of vote	Share of vote
Democratic Justice party Roh Tae Woo	34%	36%
Party for Peace and Democracy Kim Dae Jung	19%	26%
Reunification Democratic party Kim Young Sam	24%	27%
New Democratic Republican party Kim Jong Pil	15%	8%
Others	8%	3%
Total	100%	100%



law, were struck from the list of ruling-party candidates for the parliamentary election, and other top officials, such as the governor of the Bank of Korea, have been replaced. But Mr Roh's appointment of a former general associated with the Kwangju suppression as new secretary-general of the Democratic Justice party, and his failure to purge his cabinet of ministers from the Chun days, are the wrong kind of signals to be sending to a suspicious electorate.

Taming the vortex

Mr Roh's promises of an end to authoritarianism will best be served by the institution of checks on his authority. The divided National Assembly is plainly one such check, though it remains to be seen how effective it will be. The new constitution has in theory weakened the executive and strengthened the legislative arm of government. The president has lost his right to assume emergency powers, and to dissolve parliament. He is limited to a single five-year term. But Mr Roh is president not only of the country but also of the Democratic Justice party (DJF), which is still the largest single party, with 42% of the seats in the new assembly, and the hope of the support of Mr Kim Jong Pil's party, with 12%.

The judiciary is not much of a check. Mr Hyun Hong Choo, the legislation minister admits that he cannot think of a case where the courts have struck down a law or an executive order. Mr Hyun has been instructed to set about "institutionalising de-

mocracy" with new laws, though there has been no sign of that happening yet.

The strongest check on Mr Roh is still the people: not the radical students, but the middle classes. They have approved his election, just as they refused to have him foisted on them by Mr Chun last June. But only 36% of the electors actually voted for him in December and only 34% in April. Their approval was limited and the middle classes, in particular, are watching for any sign that he is breaking his promises.

One has already been bent. In December Mr Roh promised to institute elections for local-government offices before the Olympic games. These have been put off for at least a year. Even if they occur, they will permit the election only of councils, which are unlikely to have much power over finance. Mayors and provincial governors will still be picked by central government.

Freedom of the press was another important promise, and another check on authority. Some 20 newspapers and scores of periodicals have applied for permission to publish, though the government does not have a convincing explanation for why they need permission at all. They will get it, eventually. But a ludicrous law now demands that any new paper must own large presses—a palpable attempt to block independent, radical opinion.

Using this law and taking advantage of the inertia of the country's bureaucracy, the government delayed giving licences to any of the new dailies until the day before the legislative election. Several, including the *Hangyore Shinmun*, wanted to go before then. The *Hangyore Shinmun* is staffed by many journalists sacked by Mr Chun: they are no friends of the government cause.

The government also talks of allowing privately run radio stations, but there is no chance of any independent television stations. Control of television is potent. On the Sunday evening before the presidential election, the government showed the film "The Killing Fields" as a crude reminder of what instability is like—an old Marcos trick.

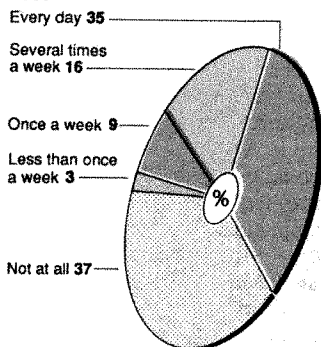
One area where the laws have been eased is in labour relations. Until June 29th last year South Korean trade unions were docile. Some 2,600 of them seldom managed more than 100 strikes a year: they, and especially their national federation, were government puppets. In the three months following Mr Roh's speech, there were 3,300 strikes, and 1,400 new unions were formed. All unions are now pushing hard for more pay. Less than 10% of the workforce is unionised and the unions are badly organised, but they are the most potent counterweight to the president's authority. That is a role that the political opposition must now assume.

We three Kims

By refusing to field just one candidate in last December's presidential election, Mr Kim Young Sam (who got 27% of the vote), Mr Kim Dae Jung (26%) and Mr Kim Jong Pil (8%) allowed Mr Roh to sneak home with only 36%. The first two Kims tried to merge their parties in time for the parliamentary election last month, but failed. Almost everyone predicted that this would mean electoral disaster. But in the event, the remarkably strong showing of Mr Kim Jong Pil (who picked up 15% of the votes)

Room for more news

Frequency of newspaper reading, 1985



Source: Economic Planning Board, Social Statistical Survey



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and the strongly regional nature of the voting has given the three opposition parties a rather flukey 174 seats out of 299. What they do with their strength is now the most interesting question in Korean politics.

Mr Kim Jong Pil is the key to the puzzle: he has become, in a way, the second most powerful man in South Korea. But he describes the prospect of a formal alliance with the DJP, as "totally unthinkable". Though his party won only 35 seats, that is enough to allow him to act as a power broker between the two Kims and the DJP. This is a much more attractive prospect for him than formally collaborating with a far from popular government. He speaks of "co-operating" with the opposition to prevent a relapse into authoritarianism. He also wants to see more open government, and is prepared to help legislate for it if needs be. Mr Roh has a presidential veto, but he will not care to be seen as the man who says "no" (which is how his name is pronounced). Mr Kim will also be pushing for more investigations into government corruption.

On the other hand, Mr Kim will not allow chaos. As befits a man who was prime minister under the dictatorial president Park Chung Hee, he will also use his party's seats to prevent such undignified scenes as a deadlock over the budget or the sort of legislative paralysis which observers of the fiery rhetoric and public posturing of both Mr Kim Dae Jung and Mr Kim Young Sam now fear. Quite how Mr Kim Jong Pil will vote is still unclear.

There is some hope that all parties will be able to find plenty to agree on. The new constitution, a model of liberalism, was a jointly agreed document. Mr Kim Dae Jung and Mr Kim Young Sam are not divided by deep doctrinal disagreements. There is little policy difference between any of South Korea's parties, and in both elections policies were hardly discussed, unless the making of wild promises to everyone counts.

True, Mr Kim Dae Jung is generally considered to be the Social Democrat, drawing his support from labour, while the middle-class Protestant Mr Kim Young Sam might be thought of as the Christian Democrat. But the rock-solid support of each candidate in his home region, with Mr Kim Dae Jung invincible in south-western Kwangju and surrounding Cholla and Mr Kim Young Sam in south-

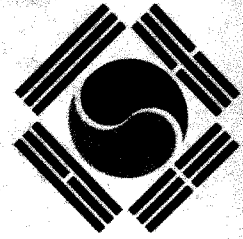
eastern Pusan and, to a lesser extent, the surrounding province of South Kyongsang, indicates the favourite son syndrome is the more important factor. Other than in Seoul, no candidate scored highly away from home. In Seoul the result was thoroughly mixed. Though Mr Kim Dae Jung won most seats (17 out of 42), the voting was very close.

Some prophets of doom think that this heralds ever-deepening regional conflict—in the words of Mr Kim Dae Jung, an East-West split to add to the North-South one. There is a degree of truth in this. Since the war, all of South Korea's leaders have been from Kyongsang, and Mr Roh, who hails from Taegu, North Kyongsang's capital, is no exception. The enmity between Cholla and Kyongsang is ancient: they were once warring kingdoms before Shilla—modern Kyongsang—won out.

But above all, South Korean politics is based on personality. Mr Kim Dae Jung's Party for Peace and Democracy did not even exist until November, when he split away from the Reunification Democratic party which he and Mr Kim Young Sam jointly led. There was no dispute other than the crucial one of who should be the presidential nominee. Negotiations to reunite the parties for the parliamentary election foundered on just the same leadership question. Both Kims have long and colourful histories of dissent: Mr Kim Young Sam is a veteran opposition parliamentarian and hunger-striker. Mr Kim Dae Jung narrowly lost a presidential election in 1971, and has in his time been exiled, imprisoned and sentenced to death. Their goals, at least in terms of new laws, are not incompatible.

In the past the opposition, denied even the shadow of power, could do little but be obstreperous. Now, all three Kims have a chance to appear as statesmen. Now all have their eyes on the presidential election of 1992, from which Mr Roh is constitutionally debarred.

After the last election, Mr Kim Dae Jung immediately promised an end to confrontational politics. He vows to co-operate both with the other opposition parties and with the government in order to ensure both reform and stability. Everyone agrees that stability is necessary for continuing economic progress: and their economy, one of the world's fastest-growing, is something about which South Koreans are particularly proud.



A man-made miracle

THE economic achievements of South Korea are often called miraculous. Mr Shin Se Ho, the vice-president of the Korea Education Development Institute, objects to that description. South Korea, he says, has built itself on hard study and hard work. More than 90% of its children are educated up to the age of 18, and more than one-third of them go on to university. Volumes of poetry sell in the hundreds of thousands: Sartre's "Being and Nothingness" appears in the bestseller section of one academic bookshop. The standard South Korean working week is meant to be 48 hours, but the average is 54. At nearly 2,500 hours a year, South Koreans work 25% more than the industrious Japanese

and nearly half as long again as Americans.

Industrialisation began with President Park Chung Hee, who ran the country from his coup in 1961 to his assassination over dinner in 1979. Park's policies, which were followed, with liberalisations, by Mr Chun, recognised that South Korea was too poor to rely on domestic demand to get the economy moving, and that it needed foreign exchange to buy its food, oil and capital goods. In a terrific gamble with other people's money, the government borrowed heavily and invested the proceeds in export industries and the infrastructure to support them. South Korea was exporting colour television sets to America before its own television stations were

The economy is an elaborate house of cards whose foundations are becoming firmer



broadcasting in colour. Most of the money came from America: the components and the machinery to put those sets together came from Japan. Import barriers protected the fledgling enterprises.

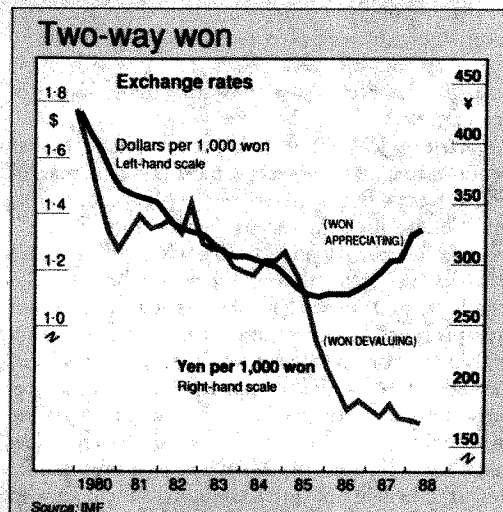
The bulk of the investment went into heavy industry: steel, shipbuilding, petrochemicals, cars. These are all businesses with big economies of scale. So concentration on them encouraged the growth of vast companies like POSCO, Samsung, Hyundai, Daewoo and Lucky-Goldstar. They started out doing contract work for others: but the West is starting to see their names on billboards. Goldstar, the electronics group within the Lucky-Goldstar group, makes nearly half its sales under its own name. Hyundai cars, which are about the only cars Americans can buy for even less than Japanese ones, are selling everywhere.

POSCO is perhaps South Korea's most striking success. A 20-year-old stripling in a greying industry, almost the only big steel company in the world to make big profits. As Nippon Steel reluctantly admits, it is also the world's most efficient, combining imported technology with dirt-cheap manufacturing costs. POSCO exports only 25% of its production. The rest goes to assist South Korean industry—which buys POSCO's cold-rolled steel for \$320 a tonne, the cheapest price to be had anywhere in the world. Yet when the idea of POSCO was mooted in the mid-1960s, the World Bank refused to lend it money. Heavy industry, the World Bank thought, was the last thing South Korea needed.

An overwhelming hand?

A Cassandra might see the World Bank's point even 20 years on. Unlike Taiwan's economy, South Korea's depends on the successes of a few large earners. The five largest conglomerates account for 22% of all manufacturing sales, the top ten for about one-third. In the case of Taiwan, the ten largest companies generate only 4% of sales. The big South Korean companies are heavily dependent on exports: Samsung makes half of its sales abroad; Goldstar 60% (60% of which are in America); Hyundai Motor 60% as well. They, and so the economy, are peculiarly vulnerable to shifts in exchange rates, downturns in demand, or swings in protectionist sentiment.

As a whole, South Korea is disproportionately



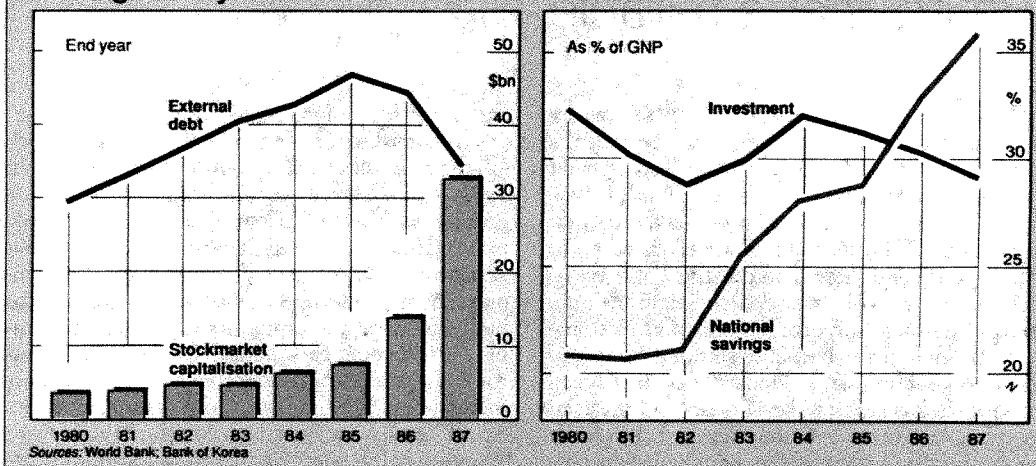
dependent on the American market, which takes close to 40% of its exports. Last year exports were equivalent to 40% of its GNP, a far higher proportion than Japan's, America's or almost any European country's. As a diplomatic hedge, South Korean companies are investing abroad, but the amount is still tiny—\$1 billion in the past 20 years.

South Korean companies tend to be heavily indebted, having raised most of the money they need through bank loans. The big groups are family businesses, and the old family patriarchs overestimate the equity stake they need to keep control of their many subsidiaries. The government is encouraging them to think again about this. Debt-equity ratios run at five or six to one, which would scare even the debt-defying Hongkong Chinese.

As a result of ill-timed government-encouraged loans to such businesses as shipbuilding and petrochemicals, South Korea's commercial banks are in such bad shape that allowing competition in could send them under. The financial industry remains all but closed to foreigners: a couple of managed funds apart, no foreign investment in the stock exchange is permitted, which saddens those who note that Seoul's bourse was about the only one in the world to finish 1987 at its high for the year.

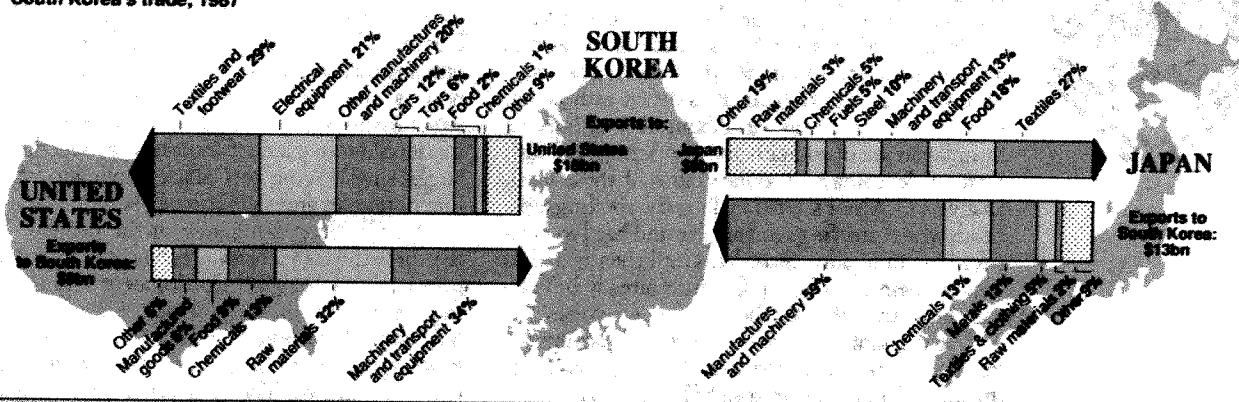
To hold down inflation, a credit squeeze is under way, and the limits are tightest on foreign banks.

Saving its way out of debt



Double trouble

South Korea's trade, 1987



Sources: US Department of Commerce, MITI

Mr Sakong Il, South Korea's finance minister, cautions the optimistic that the capital markets are "not going to open overnight". This in turn helps to annoy American trade negotiators. America has decided to strip South Korea of certain tariff concessions, and has threatened it with retaliation under Section 301 of the trade law to force it to open up some of its markets for goods and services.

The legacy of debt remains. South Korea achieved a current-account surplus only in 1986, when its debt peaked at \$46 billion. It is repaying what it owes as fast as it can: last year it slashed the sum by nearly \$9 billion, but it is still Asia's largest debtor. Imports account for about 80% of South Korea's energy needs, though an ambitious nuclear power programme is steadily reducing the proportion. During the 1970s rising oil prices put great strain on the economy: electricity was rationed and neon lighting forbidden. When the OECD countries were in recession in the early 1980s, the effect was exaggerated in South Korea. The annual 12% growth of the past two years illustrates the point: if external conditions are favourable, South Korea can do very well. If not, it won't.

Now for the good news

The good news is that South Korea is tackling all these problems at once, and so creating an economy which will be less of a candle in the wind. For this, thank a government which is technocratically impressive. A third of the civil servants in the Economic Planning Board (EPB) have second degrees from American universities. Ministries are run by people who know what they are about. The trade and industry minister used to run POSCO, and the EPB minister has run companies too. (The education minister is an educator and the defence minister a general: would that western cabinet ministers were as well-qualified.) This bright government has the good sense to interfere less and less in large companies' investment and management policies, though it still works hard to promote favoured sectors of industry at the expense of others.

South Korea has three trade problems: a \$10 billion-a-year surplus with America (which so far this year is rising); a \$5 billion-a-year deficit with Japan; and an overall surplus of \$10 billion a year. It is trying to solve them all at once by switching its ex-

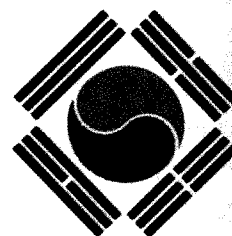
ports away from America and towards Japan, an effort which is helped by the high yen. But it must also increase its imports, except from Japan. (It also has a \$5 billion surplus with the EEC.) So it has set up a \$3 billion annual fund to subsidise non-Japanese imports.

As Mr Yu Deuk Hwan, who runs the trade part of the Ministry of Trade and Industry points out, South Korea has been liberalising its import controls since as early as 1979, long before it was in external surplus. It has been doing this first to control inflation (which was as high as 46% in 1980) and second to reduce the costs of its inputs. Last year imports rose by 28%, impressive by any standards except those of South Korean exports.

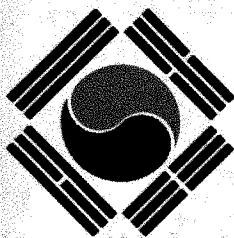
Trade officials proudly point out that the "import liberalisation ratio"—that is, the proportion of goods which are not subject to quota restrictions—has now reached 95% for manufactures, though agriculture remains well protected. The average rate of tariff is still steep at 20%, but it too is falling. What worries the Americans and the Japanese is that the relaxations are selective. A bevy of tariffs and taxes makes the sales price of a foreign car around twice that of a domestically produced vehicle with the same factory price. And imports of small cars will not be permitted until later this year. Even then, Japanese models will be kept out.

Under American pressure, South Korea was forced to let the won rise against the dollar by 9% last year, and by another 6% in the first four months of this year. The World Bank says the won should appreciate by another 25% against the dollar. Coupled with average pay increases of 17% last year (another rise of between 30-35% was being demanded in mid-April, though settlements so far are averaging only about 15%), that ought to be making South Korean goods uncompetitive. But there is not much sign of it happening yet except in such labour-intensive industries as textiles and footwear. As Japan has demonstrated, efficiency drives and corporate restructurings can push break-even points down a long way if currencies go up.

South Korea's main competitors, Taiwan and Japan, have seen their currencies appreciate much more than the won against the dollar in the past two years, though so far in 1988 both have fallen slightly against it. Exports in the first quarter of this year



Average 1987:
1,000 won = \$1.22.
Mid-April 1988:
1,000 won = \$1.35.



were up 30% on the year before, though one leading indicator is showing only a 20% increase. But the exchange-rate shifts will feed through eventually, as they have done in Japan on the import side at least.

In a world where bilateral trade balances are, alas, deemed important, South Korea needs a surplus with America to finance its deficit with Japan: so that deficit is being cut. About 80% of imports from Japan are of components or machinery. South Korea is learning to produce more of these itself. Last year Goldstar started making the rotating tape-heads which are the most valuable and hard-to-engineer part of a video recorder. Until then it had to import them from Japan. Goldstar already buys locally more than 90% of the components it uses.

At the same time South Korea is cracking the Japanese market in a way which Americans can only dream of. Sales to Japan rose 55% last year. A good chunk of that was in manufactured goods. Japan now imports more than half the radios, calculators and electric fans it consumes. Japanese companies cannot make much of a profit from these low-price items. But South Korean companies, whose wages are still less than half of Japan's, can.

South Korean industry is putting a lot more eggs into a lot more baskets. The big groups known as *chaebol* started out as tailors and general stores. They become daily more diverse. Samsung, for example, sells textiles, telecommunications equipment, fighter aircraft, ships, computers, insurance policies and much else. This survey was written on a cheap and serviceable IBM-compatible personal computer made by Hyundai, better known for its ships, buses and lorries, and passenger cars. The top ten *chaebol* comprise 284 companies between them. Their success has aroused envy and concern. Hundreds of government regulations attempt to prevent them from moving into businesses where smaller companies might have a chance. Other laws regulate the cross-holdings which make them into unaccountable monoliths.

It looks as though the measures might be working. The share of value added in manufacturing by small and medium-sized firms has risen from 28% in 1980 to almost 40% now. Such companies are promoted in many ways. Banks are required to extend 35% of their loans to them. A Small and Medium Industries Promotion Council has \$120m a year to lend on highly concessional terms; it also runs a successful scheme that has offered cut-rate technical training to 12,000 of them over the past nine years. There are already more than 100 small computer software houses in Seoul. South Korea is learning a lesson from Taiwan: that small businesses are vital to the flexibility of the economy. "No one can predict change," says Mr Suh Sang Mok, until recently vice-president of the Korea Development Institute, the government's main economic think-tank, "but we can say for certain that change will occur."

Onward and upward

The *chaebol* have their good points. South Korea has no alternative but to sell products that are technically more complex. It is no longer the cheapest maker of textiles or cheap black-and-white televisions, and both its labour costs and its currency look likely to go on rising in real terms. The credit squeeze keeps its capital costs high. So it has to

move into high technology. This year or next, electronics will overtake textiles as the leading export earner. South Korean textile companies are already shifting production to the Caribbean and South-East Asia. When, earlier this year, the Korea Development Institute and the Korea Institute for Economics and Technology attempted to guess the structure of industry in 2010, they foresaw electronics doubling to 22% of industrial production, the largest single sector; cars' share trebling to 9%; and that of textiles and steel halving.

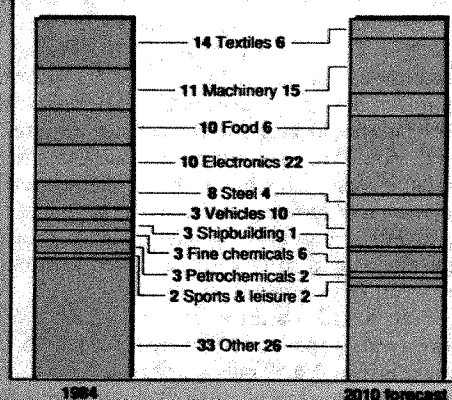
Mr Oh Sang Bong, one of the prophets, says that only the large companies have the resources to invest in technological development and to break the dependence on Japan which, for example, still has South Korean firms paying a \$10 licence fee to Japan for each video recorder they produce using the VHS standard. The large electronics companies now find that licence fees make up a bigger share of their costs than labour, which accounts for only 10%. Companies and bureaucrats worry, or affect to, that the supply of technology may be cut off. As South Korea closes the technological gap with Japan and America (in some areas, like memory chips, it is down to only two years), technology transfer becomes harder. The originators of the technology will be too intent on recouping their investment to be able to afford to license a rival.

Fear of a reaction to this "boomerang effect" is forcing South Korea to spend much more on technology. Besides, a country with advanced technology of its own ought to be able to acquire new technologies incrementally, and so at lower cost, than by buying them lock, stock and barrel. One researcher says that Japanese firms sometimes cut their licence prices in order to pre-empt a South Korean attempt to develop the technology themselves.

So South Korea is pushing money into R&D as fast as it can. It already devotes almost 2% of its GNP to R&D. That is nearly four times as much as in 1970 and compares to 3% for America and Japan. The Ministry of Science and Technology has a master plan which involves R&D spending rising to 5% of GNP by 2001, at which time South Korea intends to be among the world's leaders in high-technology. It already turns out 32,000 applied-science graduates a year—more, proportionately, than America and nearly as many as Japan. Three-quarters of the R&D

Footwear to hardware

Industrial production by sector, %



Source: Korea Institute for Economics and Technology

money is spent by private industry. The rest is spent by 16 government laboratories which were set up in the late 1970s in a successful attempt to reverse a brain-drain to America by offering American salaries to returnees.

The Korea Advanced Institute of Science and Technology is the elite scientific establishment. It gears itself closely to the demands of industry. It has 1,250 researchers working on engineering projects and developing new materials—everything from superconductors to new plastics. Most of their projects are basic research, paid for by the government. But about 15% of the institute's money comes from research contracts for private industry.

Private industry is doing its bit in other ways, too. Some 500 companies have set up their own research laboratories. Several have located them in Taeduk, a science city near Taejon which is home to nine government institutes. In one sense, though, Taeduk has failed: it has not attracted the small technological start-ups which cluster around Cambridge, England, and Cambridge, Massachusetts. Nor, incidentally, has it encouraged any joint work between companies which are bitter rivals. These companies have yet to learn the virtues of cost-sharing. The only success in this area has been a government-sponsored project in which the three largest electronics firms will jointly develop 4-megabit memory chips.

South Korea's strategy, at least for the next 25 years, is to follow two paces behind Japan. It will be a long time before South Korean technology outstrips Japan's, and there is no sign that South Korea is developing any areas of expertise which Japan or America lacks. Samsung, Goldstar and Daewoo are turning out the sort of machines that were the staple of Japan's consumer electronics industry three or four years ago: large-screen colour televisions, radio-cassette players, microwave ovens, VCRs, hand-held video cameras. The problem with making these hand-me-downs is that while turnover in the businesses is huge, profitability is modest—which is why

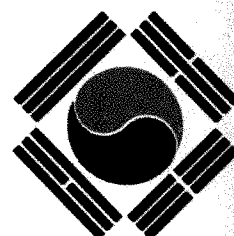
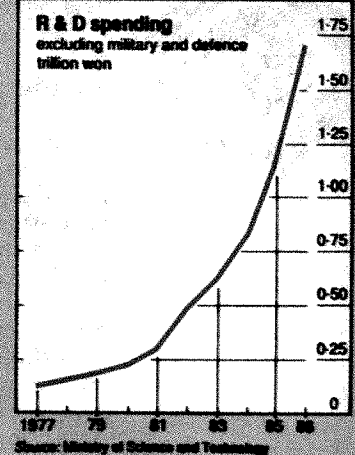
Japan is abandoning them for higher-tech items.

Just as Japan stays profitable by continuously upscaling, so South Korea should be able to, if its management stays nimble enough and the won does not soar. South Korea is now the cheapest place to buy a small car, steel, a VCR or to order a factory from. Though there are other NICs on the way, they will not be a threat this century. No future rival has the pool of skilled manpower South Korea now possesses.

Most encouraging of all, South Korea is reaching the stage where growth will become self-sustaining, just as Japan's boom is now based on domestic rather than foreign demand. Last year increased domestic demand accounted for more than half the economy's total growth. Consumption rose by 8% last year, and Mr Ro Sung Tae of the Korea Development Institute thinks it will go on rising as people start spending their larger salaries and stop saving a third of what they earn. Even a 30% pay increase this year would not be a disaster. Because labour costs now form such a small part of total costs, such an increase would add only 3-5% to factory prices. The government could compensate for that by shifting the exchange rate, if it needed to.

The return would be an economy which was less at the whim of the American trade deficit, enduring though that might seem. There is lots of work to do at home: housing must be improved and roads must be built. Preparing for the Olympics and 1986's Asian games are calculated to have generated 400,000 new jobs, of just the right domestic-demand-led sort. An educated, discriminating and ever-wealthier population of 42m packed into a country the size of Holland is something to be exploited.

Rising-tech



Division of the spoils

LOCAL accounts of South Korea's early industrialisation make no bones about it: the dash for growth and exports produced unpleasant side-effects. Government resources were concentrated on a small number of industries, which happened to be the kind that produced the worst pollution. The industries themselves were concentrated in certain areas—especially the Seoul-Pusan corridor—which led to economic development being spread unevenly around a country in which regional divisions are never far from the surface.

So much money was ploughed into economic development that there was precious little left for anything else, especially after the military and "general administration" had taken its 40% share of the national budget. More generous government spending on "inessentials" would have meant higher or more rigorously enforced taxation, and so higher costs for products which were trying to break into world markets. Making companies pay more for

anti-pollution measures, or for their workers' welfare, would have had the same effect. In the 1960s and especially the 1970s, GNP was the Great National Preoccupation.

In many ways it still is. In the subway station at City Hall in Seoul, the electronic scoreboard displaying the countries which are coming to the Olympic games lists their capitals, flags and incomes per head. But more and more South Koreans are concerned about the costs of statistical success. Pushing money into heavy industry has meant that housing, welfare, environmental protection and the care of the old have been neglected. Social development has been the casualty of economic development.

Many would argue that social development is a luxury that South Korea can afford to support only modestly. Mr Roh would like to apply for membership of the OECD before he steps down in 1993. Even then, South Korea would be one of the poor-

To enjoy the future, South Koreans need to share a better quality of life now



est members. Its income per head is half that of Singapore's or Hongkong's: the average Taiwanese is 70% richer.

Mr Suh Sang Mok acknowledges that South Korea suffers from growing pains: labour unrest, pollution, traffic jams, the lot. But he thinks that the next 15 or 20 years are vital for the development of the country. By 2010 South Korea will have lost some of its advantages. A proportionately shrinking pool of eager young workers will have to support an increasing burden of retired ones. Wages will have risen, perhaps to near-European levels. In dollar terms, average wages have been rising faster in South Korea than anywhere in the world. Over the past few years they have risen at nearly twice the rate of increase of GNP per head, and faster than productivity too. Other countries—Thailand, Indonesia, China maybe—will be strong competitors in the simpler forms of manufacturing. South Korea will be competing head on with Japan in more advanced, more technological manufacturing. So, until 2010 South Korea ought to grow as fast as it can.

That is what it is doing. The sixth national economic plan projects annual growth of 8%; for the past two years, the actual growth rate has exceeded 12%. The strains are showing. Some 300 cars a day are being added to Seoul's already stifling traffic jams. One of the world's more chaotic traffic systems simply cannot cope with them. The terrifying behaviour of bus drivers does not help. Their companies order them to keep to schedules which can be achieved only by racing. A taxi ride, when a taxi can be found, is an aging experience. Flights in and out of the country are jam-packed, as is the gleaming new wing of Kimpo airport. Though the Han river, which runs through Seoul, has been cleaned up for the Olympic games and steps have been taken to reduce the amount of sulphur in the air, Seoul's sulphur-dioxide concentrations are four times as high as Tokyo's. The polluted sea around the industrial port of Pusan is worrying Olympic organisers who are planning to hold the yachting events there.

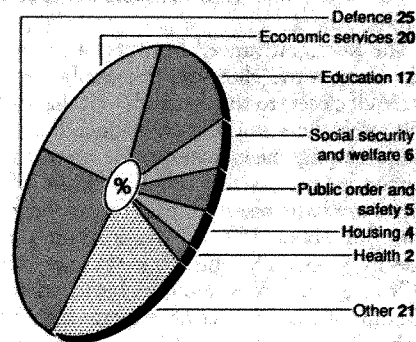
The human cost of development has been high too. Rural poverty was the problem of the 1960s and 1970s, but the drift of people to the towns and a successful rural-development programme have greatly narrowed the gap between farm and city incomes. Urban poverty is now much more of a problem. Three-quarters of South Koreans live in the cities: Seoul and its suburbs has become home to 15m people. If you have a horse, the old Korean proverb goes, send it to Cheju; if you have a son send him to Seoul. Rental housing for low-paid workers is in critically short supply. Inner-city violence is rising: robberies at knife-point and burglaries are a disagreeable new feature of life in the capital.

Inevitably, South Korea's prosperity has been built, in a way that Victorian England's Mayhew would recognise, on human suffering. Safety standards are skimpy: this April, 22 out of 28 women died in a fire in the factory which also functioned as their dormitory. These women lived and worked their 11-hour days in a space of only 35 square metres. For a month in which they got two days off, they were paid as little as 180,000 won. Industrial fatalities run at three times the level they do in America. Three in every 100 workers can expect to be injured each year.

Today's priorities

Central government spending

1987 total: 18.6 trillion won



Source: Ministry of Finance

A minimum wage is supposed to be on the books, but it has not yet come into effect because government and business cannot agree on quite how low it should be: it will probably turn out to be about 110,000 won a month, which is not enough to live on, especially in Seoul where rents are soaring. It will cover only manufacturing, and only businesses with more than ten people anyway. Many of the sweatiest sweat-shops would escape its net. Women, who on the average are paid less than half as much as men, suffer most. Many become prostitutes, working the back-streets of Itaewon, the pleasure-district that has grown up around the main American military base in the capital. Tens of thousands of others end up in Seoul's "lewd barber-shops", where a lunch-time "haircut" costs 10,000 won, including all the trimmings.

Developing a social conscience

A change of priorities is on the way. The minimum-wage bill is one sign of it. Another is a national pension plan, which was introduced at the beginning of this year, though the first workers to be provided for will be those who retire 20 years from now. A state-subsidised health-insurance scheme already covers more than 60% of the population: by 1989, everyone will be eligible. Medical care is available free to those registered as poor enough—about 11% of the population. Local governments have started building the first subsidised housing. There is no unemployment benefit as such, but the destitute get government handouts: 6.8% of the population are eligible for "life assistance"—which means that they get help with their rent and food. An equal-opportunities law has been passed, though, like Japan's version, it is short on teeth.

There are limits to how far the welfare state will develop. Interfering though it may be, the South Korean government is fiscally limited. With a tax-take of only 18% of GNP, it has always stressed self-help. Social-welfare spending accounts for 4.4% of its budget. Care of the elderly is left to their families. The exception to the state's neglect of social development is education: about 20% of the budget is spent on it.

No sooner is one social problem solved than another emerges. Grinding Dickensian poverty—"absolute poverty", as government officials term it—is

Knowledge leads to success



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one problem which is being resolved by progress and welfare. But in its place a more intractable problem pops up: "relative poverty".

South Koreans have an unrivalled love of equality. Egalitarianism has become a fine art. South Korea is the only capitalist country in the world where private yachts and private tutors are illegal. Mr Roh's government, bucking an international trend, is contemplating reforms which will make taxation, especially that of capital gains, more progressive. Income tax is already levied in 16 different bands, and less than half the workforce pays it. The top rate is 55%, with local taxes on top of that.

Equality, not just of opportunity but of outcome, is on everyone's lips. At the Korea Development Institute the support staff put up posters demanding not just more pay, but more relative to that of the senior researchers. All this seemingly runs counter to Confucianism, which preaches the maintenance of orders and distinctions. Mr Lim Ky Sop, who teaches sociology at Korea University, holds the war responsible. It shattered the fixed order and raised the expectations of everyone. Now, the display of riches invites resentment. Here is the *Korea Times* on the subject of imports:

A fundamental problem with the import of deluxe items at exorbitant cost is their luring of indiscreet and wealthy people to flaunt their ability to pay extravagant sums for luxuries, a practice which only causes disharmony between the different income brackets.

By one measure, South Korea is already one of the world's more equal societies. The Gini coefficient, which measures how far an economy's income distribution departs from perfect equality, shows South Korea to be far less unequal than any developing country, and only slightly more so than America or Britain. This is because there are few extremely rich people, and no land-owning class (comprehensive land reform was enacted in 1949). But South Korea still suffers from another legacy of Confucianism: its stress on the virtues of scholarship. To be a graduate—no matter of what—counts for far more than it should. Without a degree, a South Korean is condemned to be a production

worker for life.

The white-collar jobs that carry the chance of promotion are simply not open to non-graduates. Office workers are paid almost three times as much as production workers, though the gap has narrowed a little since last year's labour protests. More serious is the perception that university graduates are unduly favoured by employers. On average, a university graduate is paid more than twice as much as a student who completed only high school, and three times as much as one who left school at 16.

Hence the intense competition for university places. This year almost four times as many hopefuls will apply as will be selected. Until it was recently banned by "measures for the extermination of overheated private tutoring", parents were paying exorbitant fees to tutors who might give their offspring an edge. Bribery of university examiners was commonplace. It led to the institution of a strictly multiple-choice entrance examination. Since such examinations test nothing but memorising ability, only facts are taught.

There seems little chance that this will change. There are already felt to be too many university places. Graduate unemployment is a problem. The big companies and government all recruit directly from the universities. In the 1970s well over 60% of university students could expect to have a job lined up by graduation or within six months of it: now only 40% can. The unemployment rate of graduates, at 7%, is almost twice that of the national average.

As a result, pay differentials are declining. They would decline further if the government allowed market forces to turn out even more graduates. The government seems to concede the point: last year it increased the number of university places by 10%, and it is pushing more of its graduates away from the liberal arts into natural sciences. South Korea's income distribution gets fairer every year.

For a country that is still nearly as poor as Argentina or Mexico even to be thinking of making all these changes is remarkable. But the emergence of South Korea as the world's second largest ship-

builder or third-fastest developer of memory chips is remarkable, as is its emergence as Asia's newest democracy. Observing South Korea gives one the feeling of watching a speeded-up film. Visitors returning after an absence of a few years can hardly believe their eyes.

When the world's eyes turn to Seoul in September, they will see a developing country which has achieved a level of equity, education and material progress at a pace that is all too rare elsewhere in the world. If political reform continues bit by bit, as with a fair wind it may; if the outside world is kind to its economy; and if South Koreans keep a sense of proportion about their country's achievements, then the result will be a nation that can stride with confidence into a future of its own making.



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BRITAIN

A railway for sale

THE last of the commanding heights of the economy nationalised by the post-war Labour government is about to be stormed. In Whitehall, Downing Street and at British Rail (BR) headquarters, urgent work is being done on the privatisation of the railways. A commitment to sell them looks likely to be part of the Conservative manifesto at the next general election.

It is surprising that BR has taken so long to advance up the privatisation queue. Rail competes with road, and to some extent with air, for passenger and freight transport within Britain. BR is not as much of a monopoly as were the British Airports Authority or British Gas when they were sold to the public. And Sir Robert Reid, BR's chairman since 1983, was appointed to the top job only when Mrs Margaret Thatcher knew he shared her desire for privatisation. Three proposals are being discussed:

- Sell the whole network as a going concern. This, the preferred option of Sir Robert and most of those in BR who favour privatisation, is called "BR plc" within railway headquarters. There is a snag. In 1988-89 BR will receive £605m of public money. Although subsidies are falling, BR cannot maintain its network without them. From

the current financial year onwards, BR is supposed to spend its subsidy only on the provincial passenger network and Network SouthEast (the commuter lines round London). Inter-City travel and freight are meant to pay for themselves.

BR thinks that—with a bit of luck, and the kind of prices that London commuters may not like—it can get Network SouthEast to break even in a few years. It has no such hopes for the provincial network. The government is still nervous of the effect of line closures. This week the transport department signalled that it was trying to find private money to save the Settle-to-Carlisle line, which runs through beautiful country but makes ugly losses. If privatisation is not to be associated with line closures, say the fans of BR plc, the new company will have to continue to receive some government subsidy. An analogy is drawn with British Aerospace, which since privatisation has asked for more than £600m in launch aid for the Airbus.

- Split BR into regional companies, with a regulatory régime on top. This idea is explored in a pamphlet written by Mr Andrew Gritten, to be published next month by the Centre for Policy Studies, a think-tank with

a direct line to Downing Street. Unlike the old private railway companies which ran lines out of London, the new ones might split the country between them. Any subsidy would go only to specific companies. The pamphlet will probably say that prospectuses for the regional companies' sale should commit the government to phasing out all subsidy over (say) five years. This option is now being worked on in the Downing Street policy unit by Mr Greg Bourne, who joined the prime minister's team from BP after Easter.

- Form a "track authority" which would take over all BR's track and signalling hardware. Services would be put out to tender, in the hope of encouraging a new industry of private railway companies. This proposal owes much to the scheme for privatising electricity supply, where the national grid is to be sold separately from power generation. The Centre for Policy Studies dislikes this option, put forward by its rival think-tank, the Adam Smith Institute.

The Adam Smithians say a track authority is the only device through which the whole network can remain viable. If the network were split into regional companies, one might go bust. That would cause havoc for other companies, whose trains would have to run across the bust region's dodgy track. Regionalisers respond that the track authority would be a public utility with monopoly powers, and that regulating it would be a nightmare.

Which scheme will get the nod? BR officials have already been lobbying Mr Bourne in favour of BR plc, and they have some strong cards. Sir Robert is a chum of Mr Denis Thatcher (both are keen golfers). More important, ministers find it hard to ignore pleas from tough chairmen of nationalised industries who argue that, when they have successfully turned a company round, it should not be broken up on privatisation. Gas, the airports and telecoms were all sold off as blocks, as will be British Steel. Sir Robert will argue that he should be treated no less favourably.

Now that electricity has set the precedent of a break-up, however, the tide may be turning in favour of separate regional companies, which have always had some supporters on BR's board. The third option, of a track authority, may be backed by N. M. Rothschild. That merchant bank now employs both Mr John Redwood MP, who used to head the policy unit, and Mr Oliver Letwin, who worked for Mr Redwood in Downing Street and now sells privatisation internationally. The Rothschild's camp will be vehemently opposed to



Let's buy it

BR plc.

And the Labour party? From it, not a whisper. Vital aspects of transport policy—private cash for building roads and railways, and now the privatisation of BR—have moved to the centre stage of politics. But the whole debate is being conducted within the ranks of those committed to the government's objectives.

Sterling

Hard pounding

IT HAS always been Mrs Margaret Thatcher's style to fight publicly with members of her cabinet, and she usually wins. But it was unwise to take on the chancellor of the exchequer, especially as Mr Nigel Lawson also likes a scrap. Mrs Thatcher has learnt the hard way the truth of Lord Melbourne's famous adage on cabinet government: "We must all say the same."

That a prime minister has the right to be included in any big decision on economic management has never been in dispute. But such discussions have traditionally been carried out in complete privacy, excluding even most other members of the cabinet. It is no coincidence that the official residence of the chancellor, 11 Downing Street, adjoins Number 10; indeed it was through the private interconnecting door that, some time on Monday evening, Mr Lawson visited Mrs Thatcher for an hour to negotiate a solution to their public quarrel.

It has long been clear that there is a fundamental disagreement between Mrs Thatcher and most members of her cabinet over whether Britain should join the European Monetary System. Mrs Thatcher's suspicion of the EMS is deep. She remembers the long period during which British politics was dominated by the problems of trying to stick to fixed rates for sterling.

One of the Thatcher government's earliest acts, in October 1979, was to abolish



That's the pound

exchange controls—a decision taken without consulting the full cabinet. Since then Mrs Thatcher has stuck rigidly to the principle of market-determined exchange rates—even when, in October 1980, sterling rose to \$2.39, leaving a trail of havoc among exporters. As unemployment soared, Mrs Thatcher's popularity dropped to its lowest point during her premiership.

Mr Lawson, who has come to believe in the merits of managed exchange rates, last year evolved a compromise exchange-rate policy. As joining the EMS was politically impossible, sterling would instead shadow the D-mark. Upward pressure on sterling made this increasingly difficult to achieve without heavy intervention in the foreign-exchange market. Mrs Thatcher's Downing Street advisers—notably Professor Brian Griffiths, head of the policy unit—argued that intervention would dangerously expand the money supply and thus build up inflationary pressures. Just before the budget, Mrs Thatcher told the House of Commons that "you can't buck the market". Although the prime minister was patently speaking her mind, the Treasury insists that she spoke hastily.

She was more guarded on May 12th when Labour's leader, Mr Neil Kinnock, asked her to endorse a statement by Mr Lawson that sterling was already strong enough. Anxious to avoid a further disruption of the market, she said as little as possible, and was apparently dismayed when this was interpreted as renewed disagreement.

Then, last weekend, the foreign secretary, Sir Geoffrey Howe, inserted a few lines in praise of the EMS into the prepared script

of a speech. Sir Geoffrey had praised the EMS before, but the prime minister's advisers were enraged by what appeared to be a deliberate rebellion. They wonder whether Sir Geoffrey was piqued at a recent report that she expected her eventual successor to come from the younger generation of ministers. Sir Geoffrey had previously irritated the prime minister with a pacifying speech about Ireland; more recently he has challenged her tough line on South Africa.

Tory ministers and backbenchers alike were dismayed by the apparent rift with two senior ministers; although the prime minister's entourage see the rift with Sir Geoffrey as more personal than the argument with Mr Lawson, whom she claims to admire greatly. It was clear that Mr Kinnock would press on with his attack in Parliament. To defuse the row required action as well as words. Mr Lawson had to show he had won—as a matador holds up the tail of the bull he has vanquished. So interest rates were cut to 7½%, their lowest level for a decade, and Mrs Thatcher emphasised her support for Mr Lawson, and her government's readiness to use interest rates to influence exchange rates. Speculators, she said, should not to think of sterling as "a one-way bet".

It was some consolation to Mrs Thatcher that the occasion also enabled her to savage Mr Kinnock, who fluffed his words and was dismissed with "I do not think that he is entirely the master of his subject". As with the last big embarrassment for the prime minister, the row over Westland two years ago, Mr Kinnock missed a fine chance to press home an attack. In the eyes of his party, that damages him badly.

Mr Lawson, who has been considering his eventual departure from the government, and who had been staying on to oblige his boss, may now feel obliged to stay on to support her. Indeed, he may have deal with an overheating of the domestic economy which Mrs Thatcher always feared could result if stabilising the exchange rate took priority over curbing inflation. And, as the government now has no clear exchange-rate policy, his disagreement with Mrs Thatcher may soon surface again.

Health service

Opting out

SLOWLY the shape of the government's review of the National Health Service is becoming clearer. It is concentrating on the acute hospital service. Mr John Moore, the social-services secretary, has drawn up a paper that looks at the "internal market" under which money would flow with patients who cross district boundaries for hospital treatment; and at separating the paying

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Through the roof

House prices cannot forever rise more quickly than incomes. Yet there are few signs of an end to southern England's property boom

THE biggest regional reshuffling of wealth in Britain is occurring not through the work of the chancellor of the exchequer, but through the whim of the property market. House prices are roaring upwards in London and south-east England. They are beginning to accelerate in other parts of the country as they come within commuting distance of London. But northern home-owners are being left behind—with smaller mortgages and more spending power, but less valuable assets over their heads.

In the year to end-April, the house-price index compiled by the country's biggest building society, the Halifax, rose by more than 20%—the biggest jump since it was started in 1983. East Anglia has displaced the south-east as the fastest-rising market, and prices are also taking off in the Midlands—especially in places like Leicester and Grantham where commuters' journey times to London have been cut by high-speed trains. But the property market remains relatively quiet in Yorkshire, Scotland and the north, while prices are actually falling in Northern Ireland.

Plenty of pundits claim—as they have done throughout the past four years—that the market has reached its peak and that regional differences are now likely to narrow. Their strongest argument is the ratio of house prices to income. Econometric studies suggest that 70% of past changes in house prices can be accounted for by changes in real incomes. The ratio of prices to incomes may fluctuate for a while: but the experience of both 1973-74 and 1979-80 was that it peaked and then fell back. A recent study* suggests that today's ratios are higher than in those earlier booms (see chart).

While there are parallels with earlier property booms, there are also big differences. One is the patchier performance of regional markets. Another is the strength of the economy (and so of real incomes)—falling prices in 1974 and 1980 coincided with recessions. And some new factors are pushing prices up:

● **Availability of finance.** The queue for mortgages, so familiar in the 1970s, has disappeared thanks to the deregulation of financial markets. Banks, building societies and specialist mortgage groups are falling over themselves to lend up to

100% of purchase prices. Partly because lower interest rates have cut the cost of servicing a mortgage, there have so far been few defaults to discourage them.

● **Poll tax.** Abolition of rates—the last remaining tax on home ownership—may push up average prices by around 20%, according to Professor Gordon Hughes of Edinburgh University, though the government admits to only 5%. The biggest effects will be at the top end of the market, so poll tax could increase regional disparities. In theory the market ought already to have adjusted to allow for poll tax, but

2m more households in England and Wales. Many will contain only one divorced or elderly person, though the population as a whole is also rising faster than was once thought. The consequent increase in demand for houses may particularly affect popular retirement areas like south-west England or East Anglia.

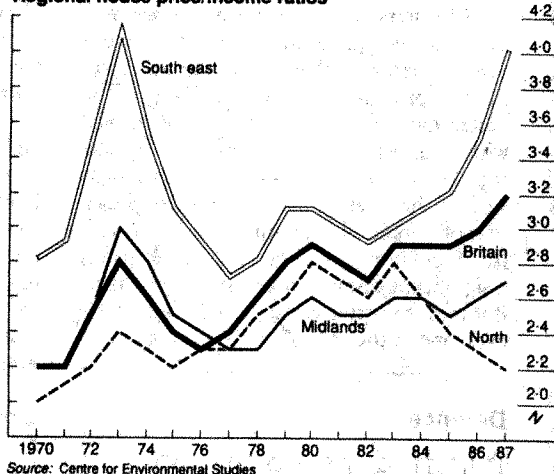
A regional policy of sorts

Many economists are disturbed about the effects of the house-price boom on the rest of the economy. Some reckon it could be inflationary: more borrowing swells the money supply, some of it leaks out from housing into consumer spending, and existing owners who feel wealthier because their houses are appreciating may spend more and save less. But rising house prices are probably more of a symptom than a cause of inflationary pressures.

A more serious worry is the effect of regional differentials on people's mobility. Northern home-owners cannot move south because of high prices; southern owners will not go north for fear of missing out on the property boom. Professor Patrick Minford of Liverpool University thinks such fears are exaggerated: he reckons the house-price differential should be welcomed because the consequent rise in business costs (including pay) will force more companies to move out of south-east England. Even the public sector is beginning to see the advantages of sending Whitehall north.

Northern Britons are losing out on southerners' tax-free capital gains, but their effective disposable incomes could be higher as a result. According to the Nationwide building society, typical first-time buyers in south-east England have to devote 35% of their disposable income to mortgage payments. Their equivalents in the north-west get away with 17%. In many industries (including the public sector), pay is fixed nationally, so southerners—even those who get London weighting—do not get enough extra pay to compensate. That could explain why retail sales in John Lewis stores grew faster last year in Nottingham, Sheffield, Newcastle and Liverpool than in London. It might also help to persuade more southerners that life north of Watford does have its charms.

Regional house price/income ratios



Source: Centre for Environmental Studies

continuing uncertainty over the fate of the government's legislation is probably delaying its impact.

● **The budget.** Income-tax cuts will boost demand, particularly at the top end of the market since high earners gained most. From August 1st the £30,000 ceiling on mortgage-interest tax relief will apply not only to individuals and married couples, but to groups of individuals sharing a property. Ironically, this is temporarily raising prices as first-time buyers club together to claim additional chunks of tax relief before the deadline. After August 1st prices could fall back.

● **Extrapolation of past rises.** Mr John Muellbauer of Nuffield College, Oxford, reckons that, if house prices are rising so fast that capital gains will exceed interest payments, people will feel able to borrow more to invest in housing. So the demand for houses increases, driving prices up faster still.

● **Demographic trends.** By the turn of the century, according to forecasts by the environment department, there will be

* "Beyond the North/South divide" compiled by CES Ltd for Black Horse Relocation, 59 Thames Street, Windsor.



I'd prescribe two pamphlets a week

health districts from the providing hospitals. That separation is desirable. More controversially, he has broached the possibility both of tax relief for those taking out private health insurance and of individuals "opting out" of the NHS altogether, taking their tax contributions with them.

The idea of opting-out is partly based on an analogy with contracting out under the state earnings-related pensions scheme. It is being pushed hard by a former cabinet minister, Mr Leon Brittan. It was supported this week in a pamphlet from the Centre for Policy Studies written by a former head of Mrs Thatcher's policy unit, Mr John Redwood. Under a different guise—that of a health credit or voucher which individuals can use either within the NHS or to buy private insurance—opting out is also being proposed by Mr David Green of the Institute of Economic Affairs.

These advocates have been heartened by reports that the Treasury has accepted the principle of opting out. This is premature: being prepared to discuss an option is not the same as accepting it. And although opting out would improve choice (at least for the middle classes) and probably increase private spending on health care, it suffers from formidable drawbacks:

- It would be hard to decide what rebate to give to those who opt out, because the amount taxpayers put into the NHS bears no relation to the health care they receive. Somebody aged over 75, who may pay no taxes, typically absorbs ten times as much hospital spending as a working taxpayer. West German experience suggests that those who opt out would be the ones who pay most towards the NHS but use it least. So the NHS could lose a lot of cash without shedding much demand.

- How could the government stop opters-

out from reverting to the NHS when it suited them? That would necessitate a whole new bureaucratic structure, perhaps even a card to identify the stayers-in. It would be expensive and probably easy to get round.

- There would be a substantial "dead-weight" cost, as the 10% of the population who already have private health insurance could claim back their NHS contributions without increasing the amount they spend on private health care.

- Opting out is hard to reconcile with the government's declared aim of ensuring that good-quality health care is available to all, regardless of means. The risk of "two-tier" clinical care emerging would be serious.

- It would become harder to control the total spent on health. The advocates say that the government should not worry if the extra spending is private. But in practice the burden would probably fall on employers, with adverse effects on competitiveness.

Ministers (and the Treasury) are well aware of these problems. Mr Moore himself says that reform of the NHS will be an evolutionary process with no "Big Bang". The better half of his proposals chime in well with health-service managers who (unlike the doctors) are surprisingly open to ideas such as the internal market—bolstered by a new opinion poll suggesting that nearly half the population would be prepared to travel a significant distance for hospital treatment if it meant shorter waiting times. But nearly everyone in the NHS is against opting out.

Defence

Nott's question remains

THE years of plenty, when the government was meeting its NATO commitment of an annual 3% rise in real defence spending, are officially over. This week's defence white paper confirmed that, for the foresee-

able future, the armed forces will have to get by with no real increase in their budgets. Defence will account for a smaller share of GDP, although still a bigger one than in most other European countries (see chart). As usual, the white paper glossed over how such austerity could be reconciled with Britain's overstretched defence commitments.

Since the mid-1960s successive defence ministers have grappled with the problem of matching Britain's security requirements to its resources. Usually, they have squared the circle by chopping Britain's ability to deploy force in distant parts of the world which it no longer rules, while concentrating spending closer to home. That means maintaining Britain's contribution to NATO.

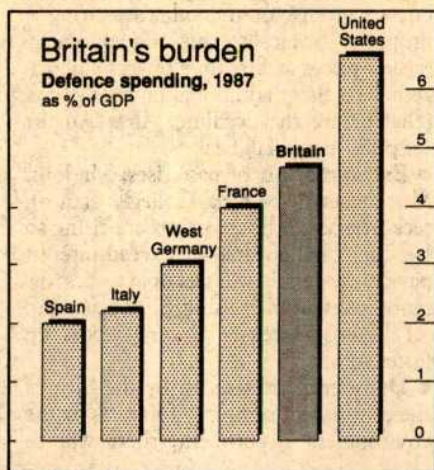
Spending cuts have therefore tended to fall most heavily on the Royal Navy and the Royal Marines. The admirals have fought a long rearguard action. Their toughest challenge came in 1981 when Mr (now Sir) John Nott tried to chop the navy in order to save enough cash to keep an effective army and tactical air force in Europe, and to provide for the air defence of Britain itself.

Argentina rescued the navy then. Britain's ships and marines performed superbly in the 1982 Falklands war; almost all the Nott cuts were restored. Yet, despite this week's bravado from the present defence secretary, Mr George Younger, about keeping a destroyer/frigate fleet of "about 50" ships, the logic underlying the Nott cuts remains inescapable. Indeed, several recent events have strengthened it.

One was the cancellation of the Nimrod early-warning-aircraft project. Several billion extra, unplanned, pounds are now being spent on AWACS from the United States. The collaborative SP-70 project for a new self-propelled gun also fell apart, taking a lot of money with it. Now a new gun will have to be bought from somewhere else. This week Mr Younger confirmed Britain's participation in developing the new Eurofight which looks like being more expensive than originally intended.

The good news is that Trident may end up a bit cheaper than planned, thanks to the depreciating dollar. But the saving will not be nearly enough to make up for other overshoots. Hence the emphasis on increased efficiency, especially in buying equipment, which accounts for 43% of the defence budget. Only just over half the ministry's contracts are awarded competitively. A report from the National Audit Office on non-competitive contracts, published on the same day as the white paper, shows that suppliers have often made bigger profits than the defence ministry intended. There is clearly scope for extra savings from more competition, and probably from more collaboration.

Even if such savings are made, the defence budget is being stretched by too many commitments. Why has it not already



Source: Defence White Paper

reached breaking point? Because civil servants have learned the technique of "moving to the right"—a euphemism for delaying buying things the services need. As a result, the army is seriously under-equipped. Most of its tanks should be replaced tomorrow; its artillery is already out of date; and its helicopter fleet is much too small. It needed, yesterday, a new anti-tank missile with a tandem warhead to defeat the reactive armour that the Russians already have in the field, but it is not likely to have such a weapon this decade.

If Mr Younger cannot squeeze any more cash out of the Treasury, he will have to cut something else in order properly to equip the army. His reluctance to face this choice suggests that the best course now would be a thorough defence review. Such a review would almost certainly be driven inexorably towards the same solution as in 1981: shrink the navy.

The Democrats

Small party seeks leader

WHETHER the Social and Liberal Democrats can once again become a political force to be taken seriously will depend on who leads them. Now that Mr David Steel, who has led the Liberals for the last 12 years, has bowed out of the contest for the job, the pretenders are starting to assemble.

The contest starts formally at the beginning of June, and the decision will be taken in a ballot of all party members in July. Already out of the race is Mr Charles Kennedy, 28-year-old SDP whizz-kid, who still thinks he is too young to stand. That leaves

Mr Robert MacLennan, currently joint leader with Mr Steel, as a possible candidate from what used to be the SDP.

Mr MacLennan, despite his obvious intelligence, appears twitchy and ill-at-ease both in the House of Commons and on television. He lacks the toughness needed to squash the threat from Dr David Owen and his breakaway SDP. He has little chance against the two former Liberals who are bound to stand: Mr Paddy Ashdown and Mr Alan Beith, who is Mr Steel's former deputy.

Mr Ashdown, dashing, smooth-talking and almost as handsome as Dr Owen, is the member of Parliament for Yeovil. He is also the favourite in the party's local-council strongholds. In a poll conducted by Thames TV's "This Week" of 803 Democratic councillors, he was supported by 67%, to Mr Beith's 10%. His achievements include commanding a unit of the Special Boat Service (the marine equivalent of the SAS), teaching

Bananadrama

ONLY in its third term has the government at last turned its free-market guns on to bananas. Why? Because it has taken a working party of officials 18 months to understand the horrid complexities of British banana policy, and a meeting of four ministers (from the Foreign Office, the Treasury and the departments of trade and agriculture) to work out how to change it.

By long tradition, free access to the British market has been given to bananas from Jamaica and the Windward Islands of St Lucia, St Vincent, Grenada and Dominica. Then it was also given to a few more countries, under the banana protocol of the 1984 Lomé Convention. All other bananas (notably those from central America, known in the trade as the "dollar area") are subject to a 20% tariff, and to quotas too. Every year the government admits, duty-free, all the bananas its favoured suppliers choose to send. Then it issues quotas for dollar-banana imports to make up the gap which Jamaica and the Windwards cannot fill.



Banana preference

Last year that gap was only a quarter of the market.

As a result, Britain is one of the most expensive places in Europe to buy a banana. Consumers respond as they should: in 1986 the British ate only 13lb each, compared with 18lb in France and 23lb in West Germany. And who is gaining from this banana preference? Three importing firms—Geest, Fyffes and Jamaica Producers—between them control most of the preferential banana supplies. Civil servants suspect that they have used their market clout to hijack the benefits originally intended to go to poor growers in the Caribbean. Nonsense, the firms reply: the islanders are quite happy with us—and there are three-firm oligopolies in other markets, even America's.

The market has long been crying out for competition and reform, but that was not what drove the government to act. The high-cost Windward Islands doubled their exports between 1981 and 1986. Under existing rules, the government would have been forced to cut its dollar-banana quotas to nothing—which would have been embarrassing in the middle of a new trade round aimed at negotiating away just such barriers. Hence the new policy:

- The preferences stay; their removal would hurt the Windwards too much. But:
- Market share for dollar bananas will be guaranteed, and supply will grow. That ought to cut consumer prices.
- To make sure it does, the government will keep an eye on prices and margins.

The next hurdle for banana policy will be 1992. Can there be a single European market for everything except bananas? If not, the EEC must agree on a single trade policy. West Germany will want to continue the free banana trade it operates now. Might not France, the only European country to grow them (its overseas islands are part of France proper), want bananas brought under the wing of the Common Agricultural Policy?

himself Mandarin and Malay, and turning a Tory majority of 11,500 in Yeovil in 1979 into a Liberal one of 5,700 in 1987.

On policy, his views are typical of Mr Steel's sort of centre, though former SDP members have suspicions about his stand on nuclear defence. Having once appeared to lead the non-nuclear wing of the Liberal party, he did a sharp about-turn at the 1986 party conference, earning himself the nick-

name of Paddy Backdown.

Mr Beith is favoured by a majority of the Democrats' 19 MPs. He is considered to have more "bottom" than Mr Ashdown: a word which loosely represents the traits of solidity, sober judgment and weightiness. He is respected in the House, where he has been a party whip, sat on several parliamentary committees, and has been an MP for ten years longer than Mr Ashdown. But he has



Ashdown ahead on looks

already made the first gaffe of the campaign, by complaining that too many people were shortening the party's title to "Democrats", thereby losing the word "Liberal". It was a blatant attempt to appeal to the Liberal wing of the party, which was always uneasy about the choice of name, but may alienate the SDP establishment, which was leaning towards supporting him rather than backing Mr Ashdown.

Mr Beith is no firebrand, especially when compared with his rival. Fire will be what the new party needs if it is to recover from its miserable showing in the polls. If it stays at the 7% recorded in the most recent Marplan poll for the *Guardian*, nobody will care who is at the helm.

Television

Axe that axe!

B RITISH television is becoming more violent. It shows more violence than almost any other country's networks. The more brutality a country's TV carries, the more violent that society becomes. The government thinks it is time something was done. True? Widely believed, but, apart from the last assertion, false.

● Since reaching a peak in the 1940s, British TV programmes have become much less violent, according to research by a team at Aston University. Programmes made just after the second world war had, on average, 4.8

Programmes containing violence

Prime-time drama

	% of programmes	Violent acts per hour
Japan	81	7.0
USA	80	5.5
Holland	80	5.8
New Zealand	66	5.7
Australia	66	7.4
West Germany	na	8.6
Britain	56	2.5

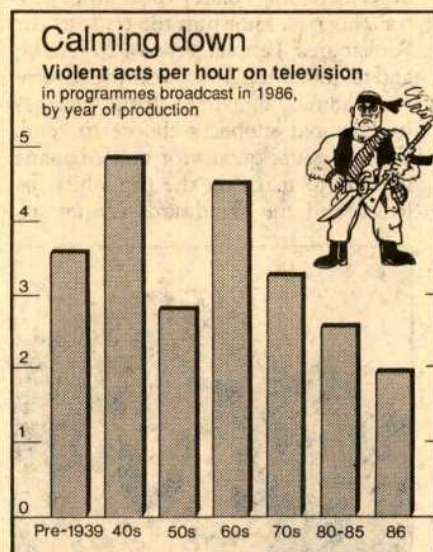
Source: G. Cumberbatch, Aston University

acts of violence an hour (see chart). That has declined steadily since the 1960s to 1.9 in 1986.

● British TV shows less than half the amount of violence shown in any other country for which reasonably reliable data exist (see table). The average of 2.5 violent acts per hour in Britain on prime-time drama programmes compares with 8.6 in West Germany, 7.4 in Australia and 7.0 in Japan.

● Japan, that famously unviolent country, is near the top of the violence-on-TV league. For violent acts per hour, aggressive America is sixth out of seven.

No clear evidence exists to link real-life violence to what is shown on TV. Nonetheless, the British viewing public is worried. In a recent MORI poll, 69% of people thought violence on TV was a problem, even when shown after 9pm. Broadcasters accept that the climate of opinion has shifted since the



Source: G. Cumberbatch, Aston University

1960s. News bulletins show less gory detail than they did then (and much less than in other European countries). The BBC in particular feels that the government is breathing down its neck.

It is. The prime minister herself, as part of her crusade to restore traditional moral values to the country, is determined to "clean up" television—a task which sits uncomfortably with her determination to deregulate the industry and extend choice for the viewer. Television will soon be brought within the scope of the obscenity laws. A new Broadcasting Standards Council was set up this week, headed by Sir William Rees-Mogg, a former editor of *The Times* and deputy chairman of the BBC, and currently chairman of the Arts Council. He is one of those who believe that standards are too low at the BBC. "The public monopoly and funding of the BBC will not survive," he wrote recently in the *Independent*, "unless the corporation can regain the editorial standards on which it was founded."

The council will be similar to the press council, but with statutory backing. Its mode of operation will be to shame broadcasters; not only may the council's findings have to be broadcast at the same time of day as the original programme, but tabloid newspapers will delight in BBC-bashing stories (with more prominence than they give to the press council's findings on themselves).

Before its statutory backing arrives (in a broadcasting bill due in the 1989-90 parliamentary session), the new council will be asked to draw up a code on sex, violence and "standards of taste and decency" with broadcasters and video producers. It will monitor such standards, deal with complaints from individuals and organisations, undertake research on the effects that sex and violence on TV might have, and produce an annual report.

Most controversially, Sir William has said he wants the power to preview some in ported fictional material before it is transmitted: programmes like "Miami Vice" or "The A-Team". The BBC is mightily miffed; so is the IBA (which oversees ITV and Channel 4). They say they preview and edit these programmes already. More seriously, they fear that Sir William will want to extend his remit to programmes like "Death on the Rock", a documentary on the Gibraltar shootings, which the government wanted to stop.

They hope that the new council will become too preoccupied with video, cable and satellite to concern itself overmuch with terrestrial TV. Sir William thinks that the big cable and satellite companies will toe the line on porn and gore, but worries about "cowboy" companies. If Dirty Dirk from Amsterdam chooses to beam in soft porn to Britain, who is to stop him? Sir William thinks he could penalise advertisers; but what if Dirk chooses to start a subscription channel? Sir William thinks he would like to be made a criminal offence to subscribe. The Home Office is puzzled by such ideas: are the police really going to raid people's houses to see what cable or satellite channels the TV can receive? And anyway, whatever happened to that old intention of widening consumer choice?

Lord Cockfield

Arthur's seat

JOCKEYING has already begun to replace Lord Cockfield, the senior British member of the European Commission. He will be dropped: not simply because he has irritated the prime minister by prosecuting the idea of the European single market with zeal. He will be 72 in September. And he is thought to have been insufficiently defen-

SAINSBURY'S

Group Sales Exceed £5 Billion

1988 Results

£ million	1988	1987	% increase
Group Sales	5,009.5	4,043.5	23.9
UK Sales	4,558.0	4,043.5	12.7
UK Retail Net Margin	6.62%	6.19%	
Profit Before Tax and Profit Sharing	332.3	268.1	24.0
Profit Sharing	23.9	21.2	12.7
Profit After Tax and Profit Sharing	199.4	158.0	26.2
Earnings Per Share	13.57p	11.16p	21.6
Dividend Per Share - net for year	4.2p	3.5p	20.0

Sales: At over £5 billion, Group Sales are the largest retail sales of any UK based company.

Profit: Group Profit increased by 24.0% - the ninth successive year that it has grown by 20% or more. Retail margin has again shown a significant increase to 6.62% (6.95% V.A.T. exclusive) while at the same time our prices have remained highly competitive. Productivity has increased by a further 4%.

New Supermarkets: The 16 new Sainsbury supermarkets opened in the year are trading at 15% ahead of their expected level. Our supermarket opening programme is already firm for nearly three years ahead and will average 20 per year.

New Technology: We are leading the way in the application of new technology to supermarkets. Nearly 80% of our supermarket sales pass through price scanning checkouts. This represents almost three quarters of all food scanned in the UK.

Shaw's: The acquisition of Shaw's was completed in July. The company is performing well and, with a strong management team, has excellent prospects for expansion in the prosperous New England market.

Homebase: Our home and garden centre company increased sales by 28% to £137 million and operating profit by 40.5% to £4.3 million. Fifty Homebase stores will be trading by next spring.

SavaCentre: Profit increased by 18.5% to exceed £20 million. Three new hypermarkets are planned to open in the next two years.

Staff Profit Sharing: More than 37,000 staff will receive over 10% of pay in cash or shares through the profit sharing scheme. More than 30% of staff are now shareholders.

Good food costs less at Sainsbury's.

BRITAIN

sive of British interests outside his own sphere of responsibility. A little touch of the *communautaires*, thinks Whitehall, is fine; just don't go native.

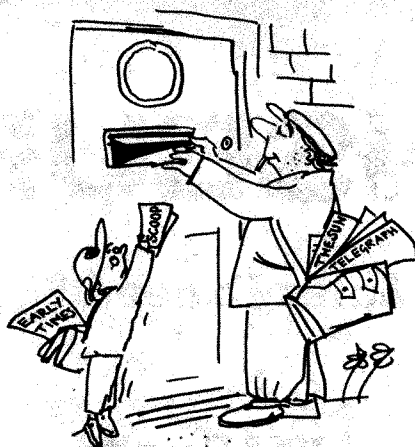
Downing Street is expected to name his successor in September. His replacement, it has been decided, must be a politician, and must get on with Mrs Thatcher. The front runner is Mr Leon Brittan, who left the cabinet after the 1986 Westland row. His seat in Parliament (for Richmond, Yorkshire) is as safe as houses, and he might see Brussels as a way of relaunching a political career. Another contender is Mr David Howell, also a fallen cabinet minister, whose seat (Guildford) is just about SLD-proof. He has a reputation as a thinker on great matters (the rise of Japan; the coherence of Europe) but is indecisive.

One other thought. Mrs Thatcher admires neither of these two men as much as she does Dr David Owen. He combines Europhilia with the bulldog attitude in defence of Britain's interests that Lord Cockfield supposedly lacked. Though Dr Owen may hesitate to rat on his sunken ship of a party, why not offer him the job?

Children's newspapers

Small market

IF YOU were ten years old, would you spend your pocket money on a weekly newspaper? Garth Publications thinks you would, and published *Early Times* in January. Senator Newspapers thinks you would not buy *Early Times* if you had a choice,



and has launched a rival called *Scoop*.

Early Times treats children as adults. Its latest issue carries stories on the attempt of Nestlé and Suchard to take over Rowntree, the appointment of the French prime minister, and the resignation of Mr David Steel. *Scoop* treats children as children. Half the paper is in full colour, it contains a pop pin-up, and on the front page of the first issue is a story on the extermination of the Sumatran tigers, headlined "Grrr!"

Early Times claims a circulation of 50,000, although it is unclear how many copies are bought by parents. Results from *Scoop*'s test market suggest that 100,000 children might buy it, and they will be urged to do so frequently by advertising on break-fast-time television.

Both papers hope to take advantage of the spending power of British children. A recent Gallup survey found that in 1988 the average eight-to-ten-year-old had £1.54 a

week to blow, and the average 11- to 13-year-old had £2.36. Combined, the two age groups get more than £400m a year.

Both papers may find it difficult to squeeze money out of the young. Neither is cheap, by pocket-money standards. *Early Times* had to cut its original price of 50p a weekly copy to 38p; *Scoop* costs 30p. *Early Times* has found it hard to attract advertisers, though *Scoop* hopes to fill up to a quarter of its space with ads.

There is a gap in the British market between comics and magazines for teenagers, but it is a difficult one to fill. Garth and Senator both exist only to publish their respective papers. Larger publishing groups have researched the gap, but then decided to stay in the safest children's market, for comics. Nobody has yet managed to emulate in print the BBC's daily news programme for children, "Newsround", which has run for the past 16 years and is watched by more than 4m viewers. The *Guardian* has a page for teenagers on Wednesday, but no other national daily has copied it.

Ominously, an earlier newspaper for children, *Younger News*, stopped publishing in April. Aimed at children between eight and 13 and launched in September 1986, it was better than either of its new rivals: readable and informative about a wide range of news, from war to pop. Its publisher claims to have been selling 38,000 copies each fortnight. But it was distributed only through schools. Some teachers thought its price (between 15p and 30p a copy, depending on the size of a school's order) too high for children. It plans to relaunch later this year, if it can find a backer.

Old folks at home

THOUGHTFUL businessmen are starting to notice the market offered by Britain's growing number of old people. In ten years' time, there will be 4m people aged over 75. And these old folks are getting richer—the disposable income of the average pensioner has risen to 70% of that of a non-pensioner, compared with 40% in the 1950s. But more money cannot prevent the gradual onset of the indignities and helplessness of old age. This is where there can be rich pickings: in the provision of luxury residential care for well-heeled pensioners no longer able to look after themselves.

Private residential homes now provide more places for old people than local authorities, partly thanks to burgeoning public subsidy through the social-security system. The government has set a tight limit on the weekly amount it is prepared to pay, and its whole policy is under re-

view following a recent report by the prime minister's health adviser, Sir Roy Griffiths. Nevertheless, most private residential care remains an unsophisticated, publicly subsidised cottage industry, typified by adapted buildings run by their proprietors.

Larger profits are to be made in more luxurious homes, financed privately. A dozen such homes are already in existence. A few belong to companies—such as the Ladbroke Group, a subsidiary of which owns 16 semi-luxurious retirement homes with a total of 709 beds. A couple of small hotel groups are also interested, as is Marriott, an American chain of luxury hotels.

One man already in the market is Mr John Hughes, an American businessman experienced in the health-care business. He reckons that about 5% of the 165,000 or so old people in long-term private residential or nursing-home care could afford much better accommodation than is now on offer. The sharp rise in south-eastern

house prices means that many old people own valuable houses. Sell a property worth £250,000 and invest the proceeds, and the income would easily cover annual fees of £15,000-20,000.

His company, Gateway Residential Services, has begun a £4m project converting a stately home in Cheshire into an elegant 60-bedroom old peoples' home with all the comforts of a five-star hotel. He provides good medical facilities on the premises so that patients can be looked after during spells of illness.

Other upmarket residential homes provide only nursing care; their emphasis is on hotel-type facilities. To get proper medical treatment requires an ambulance ride to the local general hospital. There, say critics, lies the trap. Despite the comforts, an 80-year-old widow, alone in her room all day, can lead a more isolated existence than her counterpart in a local-authority home surrounded by cronies—and she may be farther away from medical facilities.

BUSINESS THIS WEEK

Busted banks

Federal regulators started to bail out **Texan thrifts**. They are folding four bust savings and loans associations into healthy Southwest Savings, and giving it \$2 billion to help it cover losses. As long as the Federal Savings and Loan Insurance Corporation's \$10.8 billion in borrowed cash holds out there will be more such deals. But Texas's thrifts' liabilities already exceed their assets by \$10 billion.

Bids and deals



Tate & Lyle, a British sugar refiner, won its takeover battle for Staley Continental, a corn-syrup maker and food distributor, with its \$1.48 billion bid. Tate will become the largest supplier of sweeteners in America. It expects to pay outgoing management up to \$100m in golden syrup.

A prominent Texas investor, **Robert Bass**, made a \$1.65 billion takeover bid for an American publishing house, Macmillan.

The biggest-ever commercial aircraft purchase was placed by **International Lease Finance** of California. Winners of the \$6 billion-7 billion order are America's Boeing, which is to supply 100 (or perhaps 124) of the order, and Airbus Industrie, the European-based consortium, which will supply 30 (or perhaps 46). America's McDonnell Doug-

las lost out on the bonanza.

Aer Rianta, the Irish airport authority, strengthened its relations with the Russians by winning an annual \$3.2m order to repaint Aeroflot's international fleet. It recently opened the first duty-free shop at Moscow's Sheremetyevo airport.

A French firm, **Groupe Michelin**, is to set up a joint venture with Okamoto Industries to make tyres in Japan. The deal follows the acquisition of the American tyre maker Firestone by a Japanese firm, Bridgestone.

In the courts

After a two-year legal wrangle, **Eastman Kodak** reached a compensation settlement with the 16.5m holders of its now useless instant cameras. Polaroid, claiming patent infringement, forced Kodak out of the business. Kodak could pay up to \$250m.

America's Supreme Court let stand a decision barring foreign carmakers from forcing their **spare parts** on to American car dealers.

British Airways was taken to court by American Airlines, which alleges that BA's computer reservation system unfairly discriminates against other airlines.

Finance

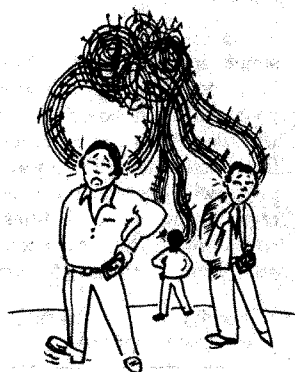
America's **Occidental Petroleum** is to raise \$1 billion in an international rights issue, the largest since the BP fiasco. It should succeed because its high-yielding shares trade more like a bond.

Spain's two biggest banks, **Banco Central** and **Banco Espanol de Credito** are to merge, so as to fight off foreign competition when EEC markets are liberalised in

1992. The new group ranks in the world's top 70.

Spain is launching a \$670m offering of 20% of **Endesa**, the state-owned electricity producer. This will be the country's biggest stock issue yet.

Air pollution



A Japanese electronics firm, **Sony**, has launched a wireless Walkman in Japan. Each set costs \$260. Headsets receive music within five feet of the player, even if it is in a briefcase. If two cassettes are playing, the headsets pick up the nearer signal.

The anti-chlorofluorocarbons lobby was joined by **Dow Chemical**, a huge American chemicals maker. It agreed to stop using CFCs, which are accused of punching holes in the atmosphere's ozone layer.

Cigarette smokers were warned by America's surgeon-general that nicotine is as addictive as cocaine and heroin. Tobacco companies reckon that his report trivialises the problem of illicit drugs.

Commodities

Pakistan will cease protecting its state-owned Cotton Export Corporation and allow it to compete with the private sector because the country is producing too much cotton. The increase is due to the use of a new cotton seed, developed at Pakistan's Nuclear Institute

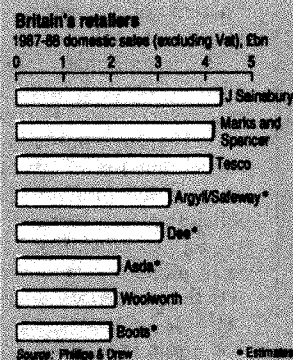
for Agriculture, which has almost doubled yields.

China plans to start increasing its output of gold. It wants to raise cash for debt service in the 1990s. The government says its output this year will be 10% higher than in 1988.

Bottom line

That famous West German carmaker, **Daimler-Benz**, increased its profits by 0.8% in 1987 to DM1.78 billion (\$1.05 billion) on sales of DM67 billion. It expects to do better in 1988, but is nevertheless cutting production by 25,000 passenger cars in preparation for a slowdown in world demand.

In contrast, **Fiat** has no plans to cut production. In 1987 it made more than 2m cars, and has reported an increase of 10% in net profit to 2.37 trillion lira (\$1.83 billion) on sales of 38.5 trillion lira. Fiat has also boosted sales from loss-making Alfa-Romeo, acquired in 1986.



J. Sainsbury, a British supermarket chain, reported a fine financial year (ending March 19th) with sales of over £5 billion and pre-tax profits of £308m (\$524m), a 25% increase above the previous year. It became Britain's top high-street store, ousting Marks and Spencer, which sells everything from socks to smoked salmon. Marks and Spencer had held the slot for as long as anyone remembers.

VIEWPOINT

The Commerzbank report on German business and finance No. 5/88

A European central bank on the horizon?

The twelve members of the European Community are moving towards economic integration, and it is generally agreed that the creation of a unified internal market, as stipulated by the Single European Act, must also have an impact on monetary policy. Indeed, if intra-Community exchange rates are still permitted to fluctuate and restrictions on capital movements remain in place, the dream of a truly "common market" may never become reality. For this reason, many are calling for closer monetary cooperation—and above all for the establishment of a European central bank, which is essential for the coordination of monetary and interest-rate policies.

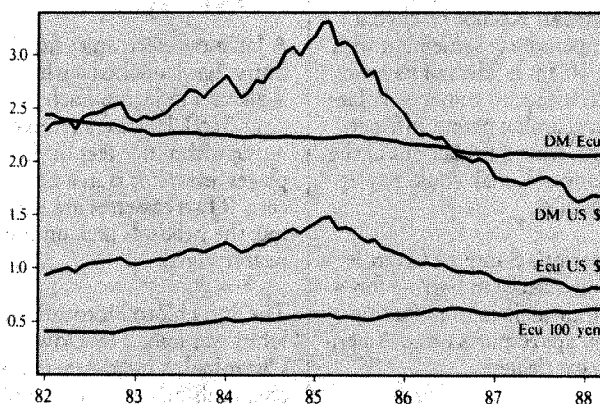
In West Germany in particular, however, experts have long argued that a European central bank can only come as the culmination of a process in which economic and fiscal policies are fully harmonised. But an assessment of European monetary cooperation over the past decade suggests just the opposite—namely, that a joint monetary policy can spur economic cooperation, promoting convergence and integration. In fact, expansion of the institutional framework of European monetary policy must go hand in hand with the integration of the national capital markets.

Coordination is even more essential in the other policy domains. In order to work, a

single internal market will need more than just a "Europeanised" monetary policy. It will also require a common fiscal policy as well as a wage policy which is sensitive to the regional and sectoral differences within this vast economic zone. There is a growing

economic needs. In the long run, therefore, this lopsided arrangement should be replaced by a tripolar global monetary system comprising a US dollar area, an East Asian yen block and a European currency zone. The Europeans will not have to

Exchange-rate trends
(monthly averages)



realisation that a unified European market in which monetary policy transcended national borders, while fiscal and wage policy did not, would be doomed to failure.

No alternative exists to such integration—as experience with the international monetary system has shown. Since the dollar is still the cornerstone of that system, the central banks' scope for action has become very limited in recent years. At times, monetary policy has been reduced to merely reacting to the dollar's hectic gyrations, often at the expense of dom-

estic economic needs. In the long run, therefore, this lopsided arrangement should be replaced by a tripolar global monetary system comprising a US dollar area, an East Asian yen block and a European currency zone. The Europeans will not have to

start from scratch, though, as they already have a prototype joint currency—namely, the European currency unit (Ecu). A system based on the dollar, the yen and the Ecu might help stabilise exchange rates worldwide. Within the EC itself, the use of a single currency would bring real economic benefits which could not

be attained if the Community continued to permit itself the luxury of twelve individual currencies. As things stand at present, the transaction costs and exchange-rate risks have prompted entrepreneurs and bankers with EC-wide business to lend ever stronger support to the idea of a currency union.

Political independence

Europe needs a central bank that is not only responsible in theory for maintaining the stability of the European currency; it must also be given the tools to do the job in practice. Such an institution must be accorded the maximum degree of political independence at both the national and EC levels. Moreover, if the central bank is to successfully preserve monetary stability, a strict separation will have to be maintained between the twin tasks of circulating money and funding government spending.

Many will consider the goal of a European central bank too ambitious and it will certainly not be achieved quickly, or easily. We cannot expect "grand solutions"; rather, gradual progress should be the aim. Yet the objective must be pursued with the same strong political will as the single European market. Otherwise, Western Europe will find it difficult to play an enhanced global role as the year 2000 approaches—a point which the Europeans now seem to be taking to heart.

COMMERZBANK

German knowhow in global finance

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BUSINESS



To Toronto, to talk trade

AMERICA'S latest trade figures suggest that its deficit is shrinking at last. The visible-trade deficit fell from \$13.8 billion in February to \$9.7 billion in March. That was the smallest monthly deficit for three years. Unfortunately, the figures are notoriously fickle, partly because America is the only industrial country which does not yet, but soon will, publish seasonally adjusted figures. Moreover, the narrowing of the trade gap in March was helped by sales of gold bullion to Taiwan and by lower oil prices. Still, America's average monthly deficit has fallen from a peak of \$15.4 billion in the third quarter of 1987 to \$12.0 billion in the first quarter of this year.

The reason is plain: America's exports are surging. Its total exports rose by 29% in value in the year to the first quarter, with particularly strong sales of capital equipment like computers and aircraft. But imports have continued buoyant, too, rising by 14% in the same period.

Can the growth in exports be maintained? The American economy is close to full capacity, so industry may be unable to meet some foreign orders. The rate of capacity utilisation in manufacturing has risen to 82.7%—its highest level since March 1980.

This is worrying, but not the stuff of panic. Firms are responding to stronger demand and capacity constraints by investing in new factories and machines.

So business investment may take over from consumer spending as the fastest-growing component of America's domestic demand this year. True, this means more imports of capital goods, which could slow the decline in the trade deficit over the coming months. In the longer term it should give American industry the capacity to meet foreign orders.

If the Americans can go to the Toronto economic summit next month pleased with their contribution to rebalancing the world economy, so can Mr Noboru Takeshita, Japan's prime minister. Japan's 12-month cumulative trade surplus has now been falling for 11 consecutive months. Will it continue to do so?

Mr Ron Napier, an economist at Salomon Brothers in Tokyo, does not think it will. Indeed, he says that between November and March Japan's seasonally adjusted trade surplus was starting to rebound already. From May onwards, the official trade surplus could show a year-on-year increase.

One reason is that Japan's terms of

trade have improved: oil prices have fallen, and Japan's dollar export prices have gone up. Second, export volumes rose by more than 4% between November and March, while import volumes rose by less than 3%. And third, the dollar has lost more than 12% of its value against the yen since October, magnifying the change in the dollar-denominated surplus. Japan's real trade balance (measured in 1985 yen terms) actually swung into deficit in February.

The performance of Japan's exporters is still tenacious and amazing. Since the Plaza accord in September 1985, the dollar has fallen from ¥237 to ¥126. Over the same period, Japan's import volumes have risen by about 45%—just as economic theory says they should. Japan's export volumes, however, fell by only 1-2% in 1986 and 1987, and have started rising again this year. Mr Napier reckons that Japan's trade surplus this year will turn out to be little lower than in 1987.

As always, other economists disagree; their reports will be in the Japanese luggage at Toronto. Morgan Grenfell, a London bank, reckons that Japan's trade surplus will decline sharply as imports continue to expand and firms build factories abroad that displace exports from Japan. A survey by the Japanese Machine Export Association found that big Japanese exporters plan to increase the share of their total output that is produced abroad from 9% in 1987 to 22% by 1992. This may help to explain some of the export resilience; Japanese firms are exporting capital goods and parts to their overseas factories. In the longer term, Morgan Grenfell forecasts that Japan's exports will rise by only 6% in volume over the three years to 1990, while import volume will



BUSINESS

OECD forecasts

	1986	1987	1988	1989
GNP % change on previous year				
US	2.9	2.9	2 $\frac{3}{4}$	2 $\frac{1}{2}$
Japan	2.4	4.2	4 $\frac{1}{4}$	3 $\frac{3}{4}$
West Germany	2.5	1.7	2 $\frac{1}{4}$	1 $\frac{1}{2}$
Current-account balance \$ billion				
US	-141.3	-160.7	-150	-132
Japan	+85.8	+87.0	+85	+80
West Germany	+37.9	+44.3	+47	+42
Inflation* %				
US	2.6	3.0	3 $\frac{1}{4}$	4
Japan	1.9	-0.2	1 $\frac{3}{4}$	2 $\frac{1}{2}$
West Germany	3.1	2.1	1 $\frac{1}{2}$	1 $\frac{1}{2}$

*GNP deflator

grow by 47%. This would slim Japan's trade surplus from \$96 billion last year to \$53 billion in 1990; the current-account balance would more than halve, to \$40 billion.

The OECD is in the gloomy school; it does not think that current-account imbalances will shrink significantly. The latest forecasts from the Paris-based club of rich industrial economies suggest that America's current-account deficit will fall to \$150 bil-

lion this year (from \$161 billion in 1987) and to about \$132 billion in 1989. Last December the OECD reckoned that the gap could shrink to \$105 billion by 1989. Its new forecasts suggest that Japan's surplus may hardly budge over the next couple of years, while West Germany's could continue to rise embarrassingly this year (see table). The blame for this lies in stronger-than-expected growth in America's domestic demand—and hence its higher imports.

Despite worrying thoughts on the imbalances, the OECD is much more bullish now about growth than it was in its December forecasts, prepared in the wake of the stockmarket crash. Real GNP in its 24 member countries is expected to grow by 3% this year (compared with a forecast of only 2 $\frac{1}{4}$ % in December), and 2 $\frac{1}{2}$ % next year (compared with 1 $\frac{3}{4}$ %). This extra 1 $\frac{1}{2}$ % of GNP growth is equivalent to the discovery of another Australia. Japan will be the star; it is expected to grow 4 $\frac{1}{4}$ % this year.

At Toronto the heads of governments will avoid arguments over continuing imbalances in trade. Until America's presidential election is over America's fiscal policy—which is mainly to blame for its trade defi-

cit—is, in effect, stalled. But if America's trade deficit starts to widen and Japan's exporters continue to amaze the world, financial markets might run the dollar down again. If so, Toronto's smiles will quickly fade.

Aircraft leasing Rent-a-jet

CLOSE to the flight deck of an airliner is a small plate which names the owner. Increasingly, the name on it is not that of the airline in whose colours the aircraft is painted, but of a leasing company. One of them, International Lease Finance Corporation (ILFC), of Beverly Hills, California, announced the biggest single commercial aircraft order on May 16th, potentially worth \$6.6 billion for up to 170 aircraft.

Leasing has become the main method of acquiring aircraft. More than half the commercial jet orders since 1982 have involved some form of lease arrangement. Many are long-term leases to finance the purchase of an aircraft, with complex deals between a consortium of banks and an airline. But there is another kind of leasing business, the operating lease, lasting from a few months to ten years. Operating leases are ILFC's speciality.

Airlines used to be in this business themselves, by hiring out aeroplanes for which they had no immediate use. Then two companies, ILFC, founded 15 years ago, and Guinness Peat Aviation, started 12 years ago and based in Shannon, Ireland, moved in. Originally, they mainly supplied used aeroplanes to airlines unable to raise the finance to buy. Now they are big customers for new aircraft in their own right.

They raise their funds on international capital markets and repay them from fees charged to lessees. The trick is to make sure the aircraft in their "pool" are never idle. So far, they have been successful. Extraordinarily, ILFC boasts that it has only ever had two leases go wrong; last year it reported post-tax profits of \$51m, up 55% on the previous year. It employs just 16 people.

The company now has bigger ambitions. It has ordered 100 aircraft, with options for 24 more, from America's Boeing (worth \$4.6 billion) and 30 aircraft, with options for 16 more, from the European consortium, Airbus Industrie (worth some \$2 billion). Mr Steven Udvar-Hazy, ILFC's president, says they are to meet the company's needs to 1995 and that customers—mostly international carriers—are already lined up for many of them. The company's recent lessees have included Lufthansa, TWA and American Airlines.

Much of Mr Udvar-Hazy's confidence is based on predictions for continued growth

Spinning to its grave

EMILE BERLINER demonstrated the first flat-disc gramophone to an audience in Philadelphia on May 16 1888. His model quickly caught on, overtaking Mr Thomas Edison's machine, invented a decade before, which ran on cylindrical records. Berliner gave birth to an industry which has ever since tried to improve the reproduction of sound—a tricky task, since sound quality is in the ear of the listener.

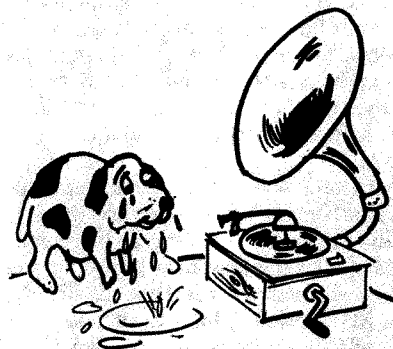
The latest attempt at perfection is digital recording. A spin-off from computer technology, digital recording breaks music down into 48,000 "samples" a second, which are encoded into "words", made of varying mixtures of ones and zeroes; these are then read by a computer and turned back into sound. Digital recording gives a uniformity and accuracy of performance, particularly on high notes, that have eluded all predecessors. It is also the system used by compact discs (CDs). Although records can use digital technology, it is only on CDs that the benefits of digital recording really show themselves.

Audio buffs say that music that is digitally recorded on CDs makes their ears hurt. Every sound is singled out and highlighted, turning music into a discordant brew of defined noises. The music lacks "warmth".

Alas for cuddly music. Money talks,

and the business of producing gramophones is no place to make it. The output of gramophones from Japanese electronics companies, the main producers, peaked in 1983. Last year 4.7m gramophones were made in Japan, roughly half the number made four years before. World sales of records have fallen from 16 billion units in 1982 to 13 billion in 1986; sales of CDs started in 1982 and reached 140m units in 1986.

A hundred years ago new inventions were much heralded, and took generations to perfect themselves in the market. Today new inventions stumble across each other in the race to the shops, and live but a little while before being pushed into an early grave by the next and better product. Nobody will celebrate the centenary of the CD.



"Isn't Holland too small for an international airline like KLM?"

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Or a tourist, enjoying the total service of KLM's complete Economy Class.

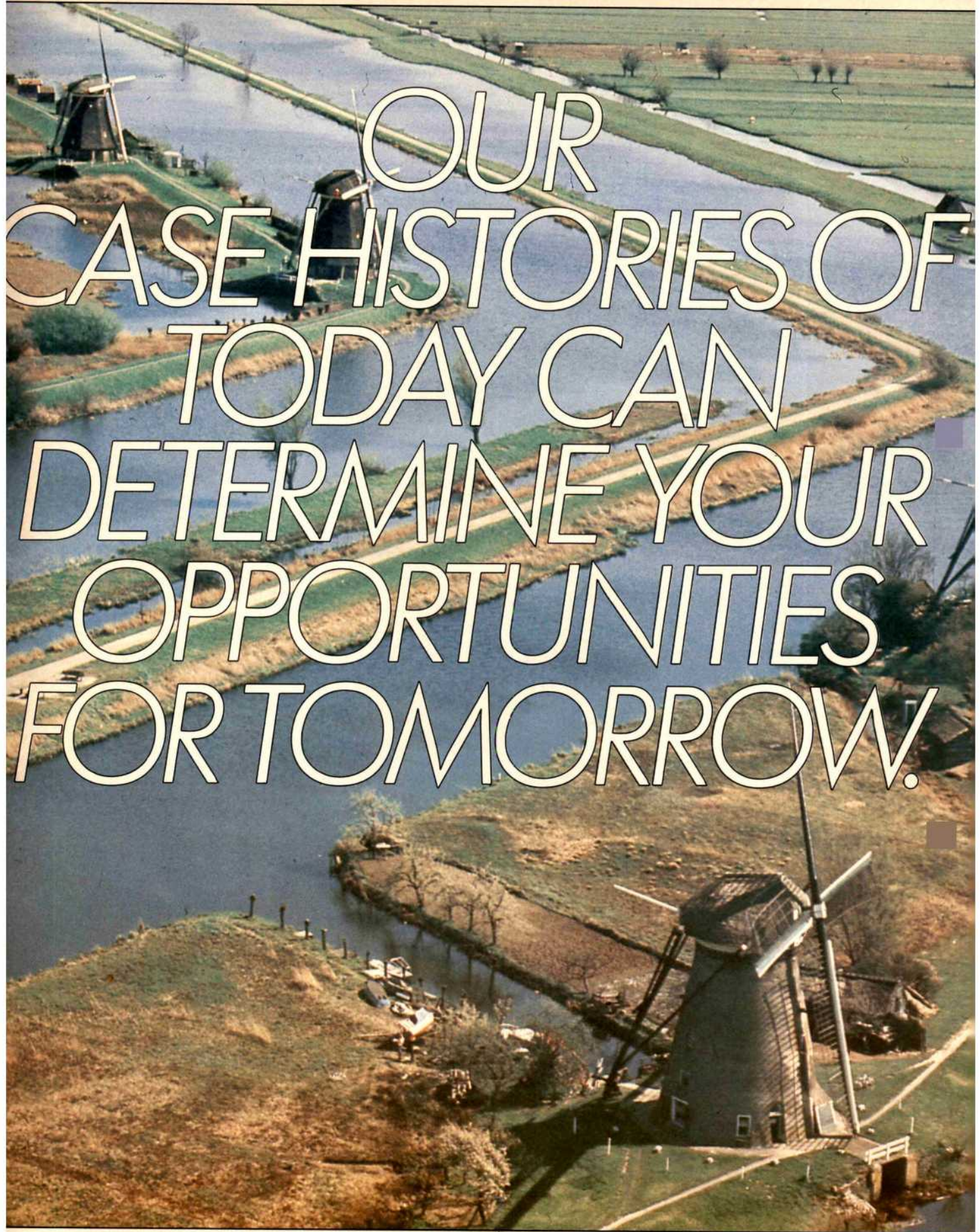
KLM's international network keeps growing. This April weekly services to Faro in Portugal and Valencia in Spain were added. And in November KLM will start a new twice-weekly service to Orlando in Florida.

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Test us, try us, fly us.

The Reliable Airline



An aerial photograph of a Dutch landscape featuring several traditional windmills situated along a network of canals and dykes. The scene is characterized by green fields, blue water, and a few small buildings. The text is overlaid on this image.

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A veritable metropolis of suitable properties are then churned out for your perusal.

Every JLW computer is linked to an intricate communications network.

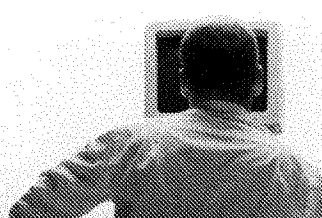
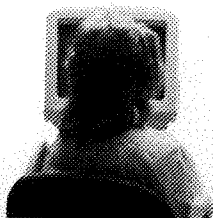
This enables us to have on file at least 85% of all available commercial properties.

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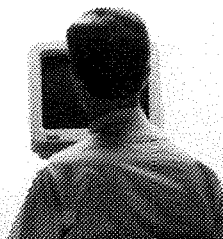
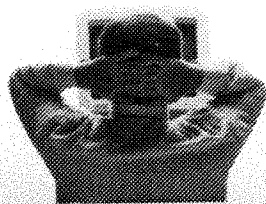
It can also help you snap up the

"I'M A MAMA
FOUND ME
SO QU
THEY SPEND A
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OSMOS/JLW/24

ED THEY A BUILDING ICKLY, LL THEIR TIME NG TV."



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It's just one of a smorgasbord of features JLW can offer their clients.

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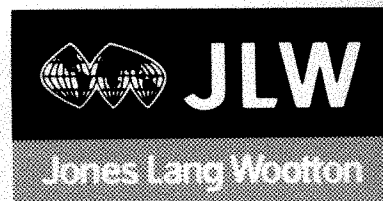
But let's be frank. Jones Lang Wootton realise that technology galore and divisions of divisions does not a property agent make.

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Whether they are professional.
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From left to right: Ian King, Malaysia; Soon-Sun Kwon, Republic of Korea; Guy Lam Kai-Pui, Taiwan; Doug Robertson, Thailand; Vivien Koh, Singapore; Eiichi Hiratsuka, Japan; Tony Hart, Indonesia

Actually, they're all Australian bankers. Or more to the point, they're all international bankers working for National Australia Bank.

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markets in which they operate. And they combine that local understanding with a thorough knowledge of international financial matters — particularly in dealing with Australia and New Zealand.

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An exchange-rate map, part 1

Exchange-rate systems usually call for co-operation between governments and/or explicit rules to limit their freedom. Which mixture works best? This is the first of two articles that aim to provide an answer—as well as an intriguing way to think about the question

UNDER rigidly fixed exchange rates there can be no such thing as “exchange-rate policy”. In effect, there can be no such thing as monetary policy either. One of the channels of economic adjustment under fixed rates is that the domestic money supply rises (or falls) automatically under the influence of changes in the country's external surplus (or deficit). In this sense, monetary control is out of the government's hands. Fixed exchange rates, in other words, force rules on governments which greatly limit their freedom of action.

Floating rates allow more discretion. Finance ministers are free to pursue an independent monetary policy—controlling the money supply either with interest rates or by other means, and relying on changes in the currency to block any external monetary influences. Governments can use this freedom in several ways. For instance, they could aim for an inflation rate that is persistently different (either higher or lower, according to taste) from that of their trading partners. Fixed rates deny them this option—one reason that monetarists such as Milton Friedman have traditionally been enthusiastic advocates of floating.

Between these pure cases of rigidly fixed and freely floating rates lies a spectrum of régimes that rely, in varying degree, on rules as against discretion. The vertical axis in the diagram represents this spectrum. The diagram's horizontal axis looks at a quite separate characteristic: it measures the extent of international co-operation on economic policy. Surprisingly, plotting the policies of different countries (or groups of countries) onto these axes reveals a wide scatter across all four of the diagram's quadrants.

The clearest case of rules-without-discretion is the pre-1914 gold standard. Under this system, countries set the value of their currencies at so many ounces of gold; that was that. Moreover, the standard required no co-operation between the countries taking part; each simply had to operate within its constraints. Rigid rules and no co-operation put the gold standard at the top left of the diagram. The post-war Bretton Woods system was only a little less rigid than the gold stan-

ECONOMICS FOCUS

dard: it allowed for occasional currency realignments. A bigger difference, however, was its explicitly co-operative nature. It yearned for, though never achieved, a multilateral approach to economic policy. In the diagram, Bretton Woods therefore sits a little below and far to the right of the gold standard.

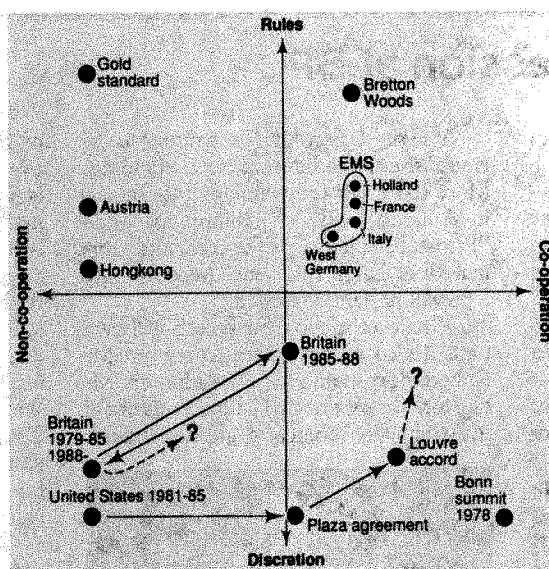
Target-zone regimes, such as the European Monetary System (EMS), are significantly less rule-bound: they allow exchange rates to vary within a prescribed band, and provide for frequent realign-

ratus. A little farther down come countries such as Hongkong, which pegs its currency to the dollar, and thus adopts a self-imposed rule—but arguably with a weaker conviction that the peg must stick. Britain's oscillating exchange-rate policy comes next. For much of the Tories' time in office the approach has been float-as-we-see-fit; lately it has veered to and fro between that and peg-plus-co-operation. (The most recent confusion over sterling is discussed on page 97.)

At the no-rules, non-co-operation corner of the diagram lies policy towards the dollar during President Reagan's first term in office. The Plaza agreement of September 1985 marked a shift towards greater co-operation, but added virtually nothing in the way of rules. The Louvre accord of February 1987 was another move to the right, but this time an upward one too, because in agreeing to stabilise exchange rates the partners endorsed targets of a sort. The G7 finance ministers insist that co-operation will continue to evolve, and some want to add “automaticity” (ie, more rules): hence the upwardly mobile dotted line. Down in the bottom-right of the chart lurks the Bonn summit of 1978, the best recent example of ambitious co-operation against a background of floating exchange rates.

If experience, as represented in the diagram, is any guide, governments do not see rules as a substitute for co-operation. In the past they have chosen lots of both, lots of one with little of the other, and little of both. No region of the chart stands out as the most successful. The top-right quadrant offers an intuitively appealing belt-and-braces approach. It also boasts the EMS, which many regard as a model of successful exchange-rate management. And it contains Bretton Woods, which lasted for almost 30 years but eventually collapsed under its own weight. Equally, the gold standard (top-left) has its advocates. Many believe that Britain's exchange-rate policy after 1979 (bottom-left) was necessary for success against inflation. And ministers now put their faith in an evolving Louvre accord (bottom right).

If all this seems frustratingly inconclusive, it is partly for lack of a clear definition of “success” in exchange-rate management. Next week's Economics Focus will start with that question, and then use the answer to make this week's diagram much more revealing.



ments. However, like Bretton Woods, the EMS presumes a degree of economic co-operation between its members. This puts it in the top-right quadrant: some co-operation, some rigidity. Different EMS members face different sorts of restriction: Holland, for example, pegs tightly to the D-mark; France accepts frequent realignments; Italy has wider currency bands than the others. West Germany has more discretion than its partners and faces less pressure to co-operate. (It would be possible to break up the blobs for the gold standard and Bretton Woods in a similar way.)

Austria pegs its currency to the D-mark even though it is not in the EMS: it therefore has a fairly rigid exchange-rate rule, but without the co-operative appa-

in the demand for air travel. Suppose that is well-founded: why should airlines want to lease aeroplanes rather than buy them? First, aircraft prices have soared; Boeing's latest 747 costs about \$125m (provided you order several of them). Some big airlines find it difficult to arrange the finance needed to replace their existing fleet or to expand. They are already spending huge sums on other expensive equipment, such as computer reservation systems.

Second, by leasing aircraft the airlines gain the flexibility to respond to changes in the market. When fuel prices change, it may make sense to switch from one aircraft to another. Smaller airlines, moreover, cannot get the discounts of a big carrier, or obtain positions in the production line that fit their plans. Leasing firms can remove this worry from them.

The leasing companies are not new boys. Boeing sold its first aeroplane to a leasing company in 1965; since then lessors have ordered 284 jets out of a total of 6,225 made by Boeing to March this year. Airbus sold its first aircraft to a lessor in 1986,

though, until now, lessors have accounted for only 5.9% of its total sales. The picture is rapidly changing. Lessors took 18% of Boeing's 1987 total and have account for more than 14% of the sales of Airbus's latest model, the A-320.

The manufacturers are having to get used to the peculiarities of the leasing companies, not least their preference for certain kinds of aircraft. Of the 100 aircraft ordered by ILFC from Boeing, 78 of them are workhorse 737s, rather than jumbos. Leasing companies will account for about 25% of future commercial aircraft orders. This will soon give them as big a say in what aircraft look like as airlines. Carriers like aircraft to be tailored to their own specifications. The bells and whistles they ask for cost money, and may not be the ones that another airline likes. Leasing companies do not bother with them. But such extras are an important source of profits for the manufacturers—something that, when they have finished ILFC's champagne, Boeing and Airbus might ponder.

Computers

The Unix wars

THE computer industry is squaring up for a fight. On one side is America's AT&T. Its opponents, which formed an organisation called the Open Software Foundation on May 17th, are led by IBM. They are vying for control of a piece of software called Unix. Sales of computers that depend on it are worth \$7 billion each year, but the battle is more important than that. It will settle how IBM and the rest adjust to a world in which the customer is master.

The brawl has been brewing since AT&T announced last year that it was going to write a new version of Unix to suit everybody. It teamed up with Sun Microsystems, a Californian company which specialises in selling computers designed around Unix. Since then companies such as Unisys and Britain's ICL have joined the AT&T club.

Other computer makers fear that the special knowledge acquired preparing this

Success and succession at BP

IS THE chairman of British Petroleum about to leave his job? Sir Peter Walters, now aged 57, would like to quit before he is 60. In January he became deputy chairman of National Westminster Bank, after almost seven years on its board. Lord Boardman, National Westminster's present chairman, is expected to step down next April. Sir Peter has been tipped as his successor. But this month, at a private meeting of BP staff, Sir Peter made it clear that he would be in the saddle a year from now.

Sir Peter, a modest chap who buys off-the-peg suits from Marks and Spencer, has transformed the world's third-biggest oil company. In the past year BP has spent \$7.6 billion buying the 45% of America's Standard Oil it did not already own and a further £2.4 billion (\$4.5 billion) to snare Britoil, Britain's biggest independent oil producer. Britoil has boosted BP's flagging oil reserves by a welcome quarter.

Most people will, however, remember 1987 as the year that the British government's sale of its 31.5% holding in BP went disastrously wrong. The Kuwait Investment Office promptly picked up 22% of the company, a stake now under investigation by the Monopolies and Mergers Commission. (The Kuwaitis failed to take Sir Peter's hints that he could live with a lower shareholding—perhaps of around 15%.) Sir Peter advised against the government's sale; he is now having to pick up the pieces.

A central part of his strategy is to emphasise BP's international standing. More than half the company's assets are in America, and "BP" is nudging aside "British Petroleum" as the company's formal title. Later this year the corporate logo will be gently restyled.

Whenever it ends, Sir Peter's will be a hard act to follow. Eager to try are Mr Robert Horton and Mr David Simon. Mr Horton was sent to shake up Standard Oil in April 1986. When BP swallowed the rest

of Standard last year, Mr Horton took over as chief executive of BP America. He is now its chairman. Mr Simon is the main-board director for finance; he is respected for his work on last year's share sale and for planning the Britoil takeover. Both men will be 50 next year—the same age as Sir Peter when he became chairman. Insiders are split on who will win, but most reckon Mr Horton has the edge. Watch for the retirement of Mr Peter Cazalet, deputy chairman of the company, early next year. If tradition holds, his successor will go on to become chairman.

Whoever wins is in for an exciting decade. After a brief period of consolidation this year, sprucing up its image and selling around £1 billion-worth of assets to cut its 36% debt ratio, BP is likely to go shopping again. It is especially keen to buy a refinery and retail outlets on the west coast of America: at present, oil from its Alaskan wells has to be shipped through the Panama Canal.

By the late 1990s BP will be looking worryingly short of oil reserves unless its exploration efforts yield another Prudhoe Bay or it buys another Britoil. However, BP is developing a process to convert gas—which it has masses of—to petrol. Not a company to brag, BP is quietly confident that it has cracked the chemistry—and that a full-scale commercial process would be viable if oil cost about \$5 a barrel more than it does today.



Nice suit, Sir Peter

new Unix will help the AT&T-Sun duo win a large slice of buoyant Unix sales. International Data Corporation, the American computer analysts, expect these to be worth more than \$20 billion, or a 23% share of the world market, by 1991, double the share of Unix today. Over the next 18 months, \$17 billion will be spent on Unix computers by the American government alone.

Companies in the new foundation think they have more chance of winning such contracts with their own version of Unix, and have now got together to write one. The list of members is impressive: IBM have been joined by Digital Equipment, Hewlett-Packard, Apollo and three European companies, Groupe Bull, Nixdorf and Siemens. Between them they account for more than 40% of the computer industry's worldwide revenues. Curiously, the Gartner group, an American computer analyst, reckons that their share of the relatively small Unix market is proportionately much less than this, probably only around 20%. So why does Unix matter so much to them?

Unix is an operating system, whose job is to oversee applications such as collecting data from memory, or sending something to

be printed out. Most operating systems are protected by intellectual property rules, and belong to one manufacturer alone. Since any application is designed to work with a specific operating system, once a customer has chosen an operating system and bought the applications software to go with it, he is stuck. Any new equipment must come from the same manufacturer. It is a sort of monopoly.

Or was. Customers now want different makes of computer to be able to talk to each other and run each other's programs. The days of operating systems controlled by one company are fading. Hence the growth in Unix; AT&T has licensed it to many companies which have then sold Unix-based computers.

Unix matters to the members of the Open Software Foundation. If they control Unix, they can make sure that any new version of it suits their old operating systems. They hope it will mitigate the decline of their own operating systems. Moreover, uncertainty about the future of Unix might encourage users to stick with the old systems a while longer. That would not disappoint IBM and its little club.

skilled. At one of the world's most automated car factories—Fiat's Cassino plant, where robots carry out 55% of the final assembly of the new Tipo car—each worker has had at least 200 days' training.

The pain of new ideas can be great. When Ford's British factories went on strike in February this year, the conflict was not primarily about wages but about the new skills which threatened to upset established hierarchies. In many companies the main reason for introducing new robots in the first place was to get past such difficulties. Robots at Britain's Rover Group and Italy's Fiat have cleared away union-set demarcation lines.

The second feature of the new machines, however, is that they are not so labour-saving as the old ones. As the chart on the next page shows, in Fiat's factories the first generation of automation cut manning levels by half; in the second generation—the move from semi-automated factories to complete automation—the manning level fell by only 20%. If this is a good guide to the future of manufacturing work, then the often-expressed worries—that robots will take over factories, leaving a few computer scientists in charge and the rest of the workforce unemployed—are too pessimistic. As automated factories become more complex and more reliant on computers, the quality of the staff, rather than cuts in their numbers, emerges as the vital issue. In a survey by *Ward's Auto World*, an American monthly, engineers placed training as their overwhelming priority, well above new technology.

General Motors is the worst example of a company that set out to save labour, and then found that it was using its remaining workers inefficiently. Between 1980 and 1987 GM spent \$42 billion re-equipping old factories and building seven completely new ones. Despite these brave investment drives, GM's market share is declining; so are its

Factory automation

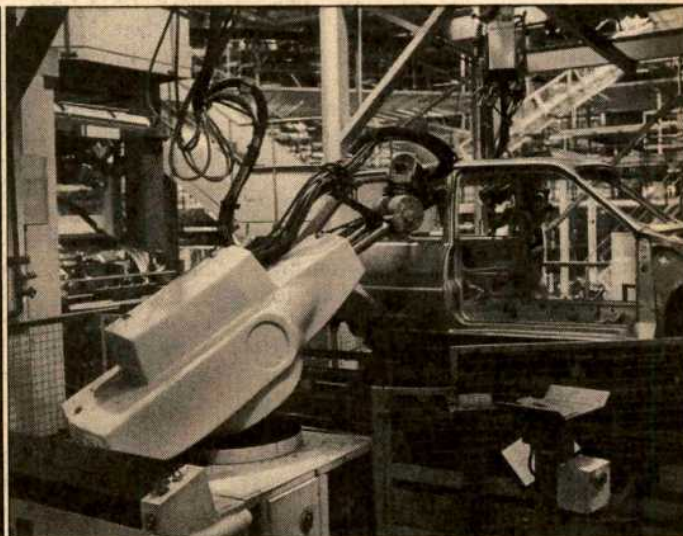
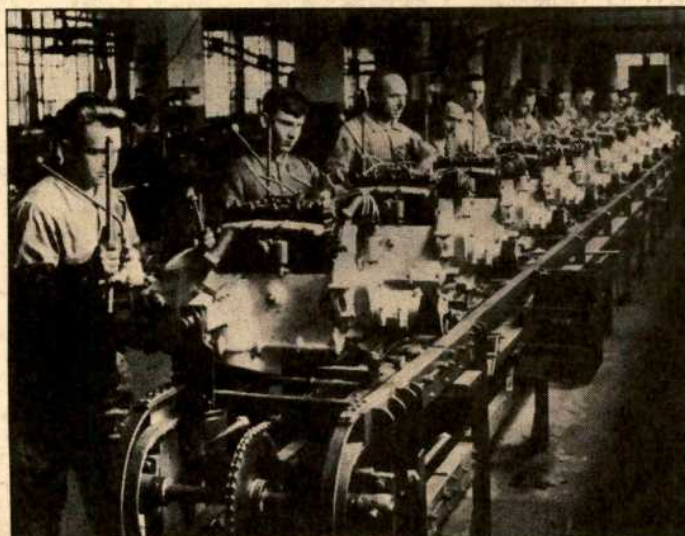
Living with smart machines

Is the half-century-long replacement of workers by machines going to slow down? Consider the case of the car industry

THE first generation of robots was brought into car factories about a decade ago to replace workers and cut costs. These automatons repeated one or two tasks—welding, say, or nut-tightening—on a single car on one long production line, endlessly and flawlessly. Ten years later the most advanced robots are capable of lots of

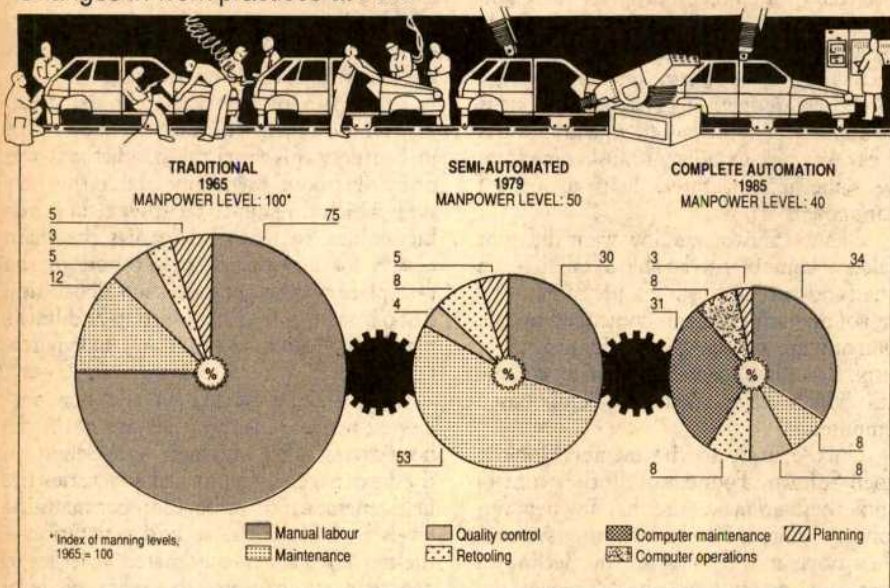
tasks; they operate in parallel, switching from one model to another as different cars flow down the production line.

These machines have increased skills all round: all workers have to know how their robots work. This, in turn, has meant upgrading the jobs of workers and a blurring of the distinction between unskilled and



Which is the robot?

Changes in work practices at FIAT



profits and its return on equity. Among the many signals of GM's woes, one stands out: last year it discovered that one of its most automated plants, a \$500m truck factory at Hamtramck, Michigan, which is operated with the help of more than 300 robots, had lower productivity and poorer quality-control than the labour-intensive plant at Fremont, California, which GM runs in a joint

venture with Japan's Toyota.

This lesson applies to all manufacturers. Mr John Krafcik, of the Massachusetts Institute of Technology, has made a comparative study of the effects of automation in 31 car plants in Europe, America, Japan, Brazil, Taiwan and South Korea. His remarkable conclusion is that "levels of technology have nothing to do with productivity." His proof

lies in the reasons behind the big exception to the rule: Japan.

The Japanese plants included in his survey had twice as many different models flowing down their production lines as their American and European rivals. Mazda's main plant at Hiroshima, for example, makes four completely different models on one line. In contrast, factories in Europe and America fitted with state-of-the-art manufacturing equipment use them to make only one or two models.

The Japanese companies make more models because they give workers more responsibility for production decisions. They learnt to do so when they first introduced their "just-in-time" system of inventory control. This keeps costs down by making warehouse managers keep track of every item in stock and know exactly how much to order when.

In the same way, flexible manufacturing systems work at full capacity only if production workers are able to take complex scheduling decisions about which car they (or rather their robots) should work on at any one time. Japanese workers are expected to move among a number of machines and work stations. Union-set demarcations are non-existent.

Japanese workers have adjusted to the idea of fully automated plants much more easily than workers elsewhere. The Japanese say this is because their consensus-seeking

To catch a thief

THEFT at work is less visible and less violent than theft on the streets. But it can be just as damaging. Some believe that the annual loss in Britain could be as high as the £1 billion (\$1.85 billion) which the Home Office reckons is shoplifted every year. The criminals are a surprising bunch. Arthur Young, a firm of management consultants, did a survey of "insider" fraud cases reported to the police by large British companies. It found that 29% of the offenders were company managers; only 19% were accounts officials, 13% sales personnel, and 3% computer operators.

Permetric, a young British firm, thinks it has a way for companies to reduce theft by employees. It does not rely on high-tech snooping gadgets but on a low-tech questionnaire given to job applicants. The questionnaire (which includes teasers such as "Do you worry about being a failure?" and "Have you ever cheated in an exam?") was devised by Mr Paul Barrett, a research fellow at the Institute of Psychiatry in London. The applicant's answers are compared with a template of the answers from a sample of over 1,000 British

prisoners, most of them convicted for theft. From the closeness of the fit, Permetric gives a rating of the applicant's attitude to honesty.

Over the past 30 years the technique has been used in America by many companies including Atlantic Richfield, Kentucky Fried Chicken and United Airlines. It makes some proud claims for itself. Over a three-year period in which a large DIY chain used the test on some 4,000 job applicants, the company reduced its "shrinkage" (an American expression for theft plus loss from damage, etc) from 4% of sales to less than 2.5%.

How scientific is the view that criminals have a distinct psychological profile? Britain's Home Office is agnostic, but has given a grant to the University of Surrey to continue looking into criminal profiles. Marks and Spencer, one of Britain's best employers, thinks the tests are unnecessary. Its shops lose about £1m a week from shrinkage, but the firm says that only a small proportion of that is from employee theft. It believes that "if you select people who are literate, numerate and with good personalities, then the likeli-



hood is that they are not going to be thieves."

Mr Barrett, though, is convinced that there is a "prisoner type". He says such a type is uncaring and aggressive, with a disregard for danger and a tendency to enjoy making fools of others. Sounds just like the boss.

management style has long encouraged workers to take responsibility for what they are doing. "The challenge," argues Mr Ramchandran Jaikumar, an associate professor at the Harvard Business School, "is to

develop and manage physical assets, not the production of goods. Choosing projects that develop intellectual and physical assets is more important than monitoring the costs of day-to-day operations."

Japanese foreign investment

Sushi and enchiladas

MEXICO CITY AND SAO PAULO

Japanese investors sometimes seem to find the world rather cramped. They are already so familiar with America and Europe that the more adventurous are starting to look elsewhere. The rest of the planet looks problematic: Africa too backward, the socialist countries too, well, socialist. This article in our series on Japan's economic diaspora looks at what is left: Latin America and, in particular, Brazil and Mexico



NO MITI master-plan is required to make these two countries targets for Japanese capital. Japanese banks are owed \$16 billion of Mexico's \$100 billion debt, their biggest stake in any third-world economy; they have lent Brazil nearly \$12 billion. Moreover, Latin American countries are among the few whose currencies have fallen against the dollar in the past three years. Hence if investors can overcome local disadvantages, the two biggest Latin economies appear to be good spots from which to export to America.

However, Japan's direct investment in the region is still relatively puny. The Japanese account for only \$1.3 billion of Mexico's \$21 billion-worth of foreign direct investment, about a tenth of America's share. Investment in Brazil is exactly twice as great, putting it, at the end of 1986, third behind America (\$8 billion) and West Germany (\$4.3 billion). The reason for these low figures is simple: even more than most multinational businessmen, the Japanese hate foreign-investment restrictions. Mexico and Brazil have plenty. Brazil's domestic-content laws, for instance, require 85% of the value of a car to be made locally.

There are cultural clashes too. The Japanese do not disguise their dismay at local attitudes towards quality control and punctuality (in Mexico, "just in time" has a rather un-Japanese connotation). Nissan's engine plant in Cuernavaca, south-west of Mexico City, was shut recently by a strike called, among other reasons, because workers objected to obligatory morning choruses of the company song. And at a recent seminar held in Sao Paulo, Japan's ambassador to Brazil, Mr Koichi Komura, told the audience that "with the exception of a minority of businessmen who know Brazil, the reality is that nobody wants to invest in a country where chaos seems to reign." (He subsequently claimed he meant "great confusion" not "chaos").

Despite these problems, Japan contin-

ues to invest more in both countries. The Japanese offer benefits. Their firms are often new to Latin America, and provide older companies with needed competition. In contrast, any new investment by an American or European investor is likely to represent expansion by companies that have been serving the domestic market for decades. The Japanese also provide a counterweight to the Yanquis.

From Japan's viewpoint, the two countries differ. Mexico offers oil, a fast-growing

nas, with a steel mill where Kobe Steel is the largest secondary manufacturer; and Salina Cruz, Mexico's only Pacific oil terminal, which is being expanded with the help of \$1 billion from the Japanese government. This Pacific investment will continue. Mr Carlos Salinas de Gortari, who will be the country's next president, is a great believer in Mexico's Pacific future; his children attend a Japanese-run school.

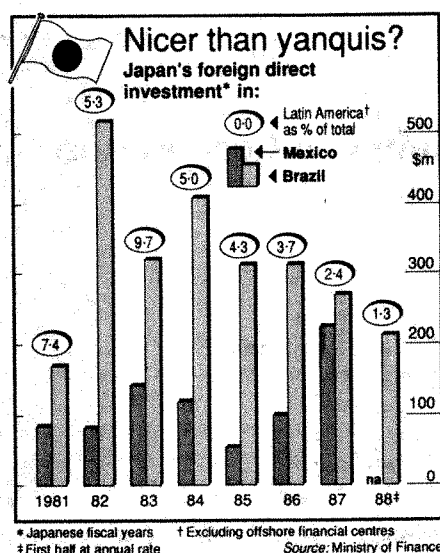
Whereas Japan's investment on Mexico's Pacific coast is designed for export, in Brazil it aims at the domestic market. Often, this is because government policies have been biased against foreign exporters. When Japanese consumer-electronics firms came to Brazil in the 1970s, they had to build their factories in the heart of the Amazon jungle, in Manaus; the then military government wanted to encourage development there.

The result, the "Manaus free zone", is a model of how not to run a regional-development policy. The factories' main customers—the middle classes of Sao Paulo and Rio de Janeiro—are 1,600 miles away, and heavy transport costs have to be offset by an indefinite tax holiday. The costs of building electronic goods in the Amazon are so high that, even with a strong yen, the Japanese can still export goods to other Latin American countries more cheaply from Japan than they can from their factories in Brazil (which are anyway 51% owned by Brazilians). So exports are piffling.

This sort of experience has persuaded the Japanese not to invest in car factories at all, even though Brazil's love affair with the motor car is as passionate as America's. True, both Honda and Toyota have factories in the country, Honda for motorbikes and Toyota for rugged vehicles that do well in rural areas. But neither produces cars, despite requests from the government to do so.

In contrast, the largest and oldest Japanese investor in Mexico is Nissan. The company recently surpassed America's big three and the traditional leader, Volkswagen, in terms of domestic sales. It is expanding exports, shipping Mexican-made engines and parts to American and Asia. And in the usual fashion, Nissan's suppliers—Kanto Seiki is the latest—are crossing the Pacific to set up their own production lines.

If Brazil decides to encourage Nissan-style exports through liberalisation, it will be able to count on at least one attraction that Mexico cannot match: nearly 1m people of Japanese descent live in Brazil, mostly in the state of Sao Paulo. Their fathers and grandfathers started coming to Brazil 80 years ago to work the land. Now they are responsible for the great variety of vegetables that Paulistas enjoy and for numerous sushi bars. Although they may not speak perfect Japanese, they help Japanese investors to feel slightly more at home in Brazil than in any other country.



Pacific seaboard and a low-cost base for exporting for America; Brazil has farming, metals and a buoyant home market.

Japan's investment in Mexico is concentrated on the Pacific coast. Virtually every big new industrial development and port there is being developed with the aid of Japanese capital and with an eye towards Japanese-Mexican trade. In Tijuana, the biggest new "maquiladora" assembly plants are owned by Japanese electronics companies. In Baja California to the south, Mitsubishi is co-owner of the Essa seasalt works. Farther down the coast are the port of Lazaro Carde-

StMichael



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May 1988

FINANCE

A hard sell ahead for America's retail brokers

NEW YORK

Wall Street's securities houses are waking up to a secret they kept so well that many had forgotten it themselves: if you run a private-client business the proper way, it can be the hottest game in town

CHARLES MERRILL, the man who took investment to the American high street in 1914, would not have approved. Merrill Lynch failed to make the bumper profits it should have in the 1982-87 bull market. Like many big Wall Street brokers, it could not resist trying to become a high-flying investment bank, catering mainly for institutional and corporate clients. The result: private-client business took a back seat, equity bases and costs grew faster than profits, and some brokers have found themselves in deep trouble.

E.F. Hutton, once a successful old-fashioned broker, had come to grief even before last October's stockmarket crash pushed it into the arms of rival Shearson Lehman. Leaner retail firms—brokers and independent mutual fund companies which stuck to their trade—did much better at keeping their costs down. For example, A.G. Edwards, a St. Louis-based broker whose business is largely with private clients, earned an annual return on average equity of 11.8% between 1982 and 1987. Over the same period, Merrill Lynch managed returns of 11.8%.

High returns on traditional retail business will be harder for anyone to make following the slump in commissions after the October crash. Commission revenue on Wall Street ballooned in the last two years of the bull market, but it is now unlikely to grow faster than the average 3% a year at which it has grown since fixed commissions were abolished on May Day, 1975. Yet, despite the growth in the 1980s, commission revenues account for a declining proportion of the brokerage industry's total revenues: 36% in 1987, compared with 46% in 1980. Big brokers are losing to discount brokers (which provide a cheap, few-frills dealing service) and regional firms. Discount brokers handled about 15% of private clients' trades in 1987, compared with 5% in 1980.

Have the big, so-called full-line, brokers

missed the boat? Broking is a changing game. Increasingly, it will have less to do with generating commissions and more to do with investment management. One reason is America's aging population; as the country's baby-boomers grow old, today's big spenders will become tomorrow's bigger savers and investors.



A second reason is that investment in shares and bonds account for a declining portion of people's savings. A bigger chunk goes into money-market and other mutual funds, chequeing and savings accounts, pensions, insurance policies and mortgages. Full-line firms' networks of local offices have already proved a natural funnel for sales of equity, bond and money-market mutual funds. These exploded in the bull market. In 1982 sales were worth \$16 billion; last year, \$250 billion. Over the same period, mutual-fund assets nearly trebled to \$800 billion.

Now brokers want to provide more of these services. If America's large stockbrokers, eg, Merrill Lynch, Shearson Lehman Hutton, Paine Webber, Prudential-Bache (owned by Prudential, an insurance company) and Dean Witter (owned by Sears Roebuck, a retailer), handle this push into investment management right, they have the chance to catch another boat.

Those brokers at the quayside say their aim is to manage clients' balance sheets—a pompous phrase, but one that gives a clue as to the scope of their intentions. They no longer see themselves as commission-driven hustlers but, in the jargon, "asset-gatherers". These assets can generate sizeable fees: Merrill Lynch pulls in \$400m a year from advisory, custodian and management fees.

Gathering the assets

The business of asset-gathering is pitting the big retail houses against the traditional providers of many of these services—commercial banks, insurance companies and thrifts. Yet the battle, at least against banks and thrifts, has been partly won. In 1977 Merrill Lynch was the first to launch a cash-management account: simply a money-market fund paying a rate of interest, against which cheques can be written. Since then, the value of such short-term funds has risen tenfold to over \$300 billion, accounting for around two-fifths of all mutual-fund assets; the remaining three-fifths are split more or less equally between equity and long-term bond funds.

These money-market funds are important to brokers (and the handful of big independent mutual-fund companies with their own distribution network). They generate annual fees equivalent to around 0.45% of the funds and offer a bolt-hole to investors who suddenly find individual shares and other riskier mutual funds within the same group too hot to handle. (Switching between funds within the same family usually costs little or nothing.) Such a set-up helps keep money out of the banking system during waves of redemptions. In the three months following the crash, money-market funds grew by 12%, bank and thrift deposits by just 1%. Effectively, broking firms have created a banking system outside the traditional one, shifting cash between one sort of deposit and another.

Merrill Lynch manages \$80 billion of mutual funds, Shearson Lehman Hutton \$40 billion and Dean Witter \$36 billion. Al-

FINANCE

though investors have been more cautious since the stockmarket crash, mutual funds are currently growing at an annual rate of 10%, compared with 24% between 1984 and 1987. That ought still to be enough for the big three to earn a return on the smallish capital committed to that business of 20-25% this year. And beyond? Those high profit margins cannot be sustained.

Competition will not come from commercial banks, even when the Glass-Steagall Act (which forbids those banks from underwriting mutual funds) crumbles. They generally have neither the mass-marketing nous nor the ear of the investor. It will come from the large independent mutual-fund compa-

nies, which have both. The largest of these, Fidelity Investments (see box), rivals Merrill Lynch in the size of its assets under management.

These companies will put pressure on the profit margins of the retail houses. They market families of funds independently, and these mostly cost less to buy than the retail brokers'. Unlike most brokers, firms like Fidelity and Dreyfus Corporation aggressively sell funds that generally have little or no front-end charge—so-called "deferred-load" funds. Instead, they charge an annual management fee and a penalty should the investor want to sell, say, within four years.

Increasingly, brokers will be forced to

provide and market their own family of deferred-load funds. Currently three-quarters of all mutual funds are sold through brokers. Sales of front-end mutual funds accounted for 24% of their entire retail commission revenues in 1987, compared with 2% in 1980, according to Mr Michael Goldstein of Sanford C. Bernstein, a research house. As brokers increasingly compete with the independents selling low-fee funds, profit margins will decline.

A costly business

If Wall Street's retail brokers are to thrive, they will have to make more of their natural channels of distribution to market other ser-

Fidelity keeps the faith

BOSTON

FIDELITY Investments, a private, family-run company based in genteel Boston, is an example of how to make money out of private clients in a way that the big securities houses have cause to envy. In the 1950s and 1960s Fidelity ran funds that were marketed by others—that is, by retail brokers. That stopped in the 1970s when stockbrokers began to market their own funds, so Fidelity (like other firms such as Dreyfus, Putnam and T. Rowe Price) was left to fend for itself. The rude awakening was its blessing. Aiming to attract the richer, more savvy investor, it now has \$81 billion of mutual funds in its care.

Although Fidelity is building up its own branch network (it has 54 outlets at present), it sells only a third of its funds through them. It has branches mainly to remind customers that it is there, and that it cares. The one on Park Avenue has more the air of a shoppers' social club than a business. The bulk of that, as with other independent firms, is handled on

toll-free telephone numbers. By letting its customers place the business themselves, Fidelity saves on salesmen's high salaries.

Fidelity's recipe has three ingredients: stylish and often aggressive marketing (all its advertising is handled in-house); state-of-the-moment technology to run customer accounts and a smooth back-office; and the performance and cost of its funds. Several of Fidelity's equity funds have been among the industry's best performers over the past 5, 10, and 15 years. Mr Peter Lynch, the manager of the most successful, the \$8.5 billion Magellan Fund, is far better known in the industry than is Fidelity's low-profile chairman, Mr Edward Johnson. Near to Mr Johnson's office is what was his father's sanctum, a large room at the top of Fidelity's headquarters plastered with stockmarket and other charts that go back to America's independence.

Fidelity also runs a discount broker (one of the five largest which, between them, handle four-fifths of all discount

trades). This dovetails neatly with its mutual-fund business because of the computer systems that move clients' money between money-market funds and brokerage accounts. Apart from this, the two businesses are run separately.

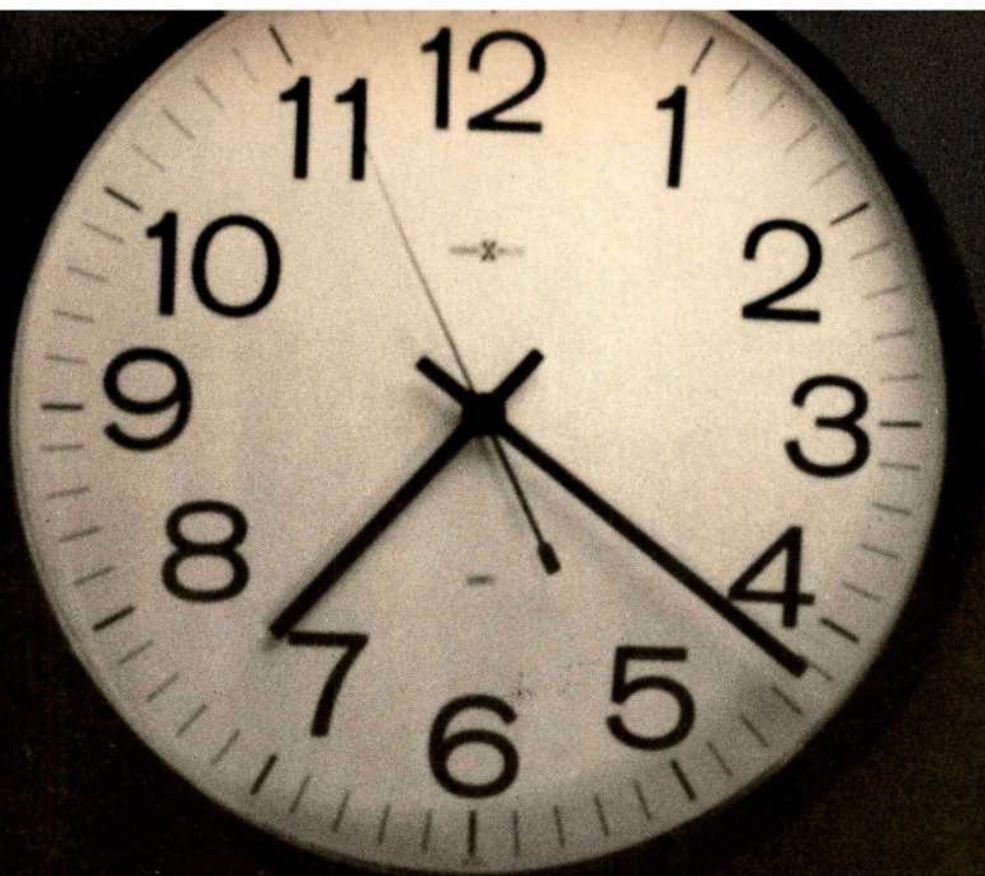
Investors complain that during the stockmarket crash they got a poor service from discount brokers, either because their calls were not answered, or their trades not executed. Fidelity denies this, saying that on Monday, October 19th, just 6% of the 500,000 customers who telephoned to Fidelity hung up before their call was answered, compared with an average of 1% in more normal times. The several tens of thousands of customers who used Fidelity's 24-hour service by lodging orders over the weekend had them executed on Monday morning. Fidelity says the only snarl-up came in the last hour of trading that day, when 4,200 orders remained unexecuted until the following day.

But Fidelity's business has still been hurt. Several of Fidelity's most popular equity funds were aggressive and risky ones. They raced ahead in the bull market and dived farthest during the crash. And most of the current investors in the Magellan Fund joined the party only in the last months of the bull market. However, Fidelity's main attraction, the ability to switch among a family of funds at no cost, passed the test of the crash. Though redemptions from the Magellan Fund were heavy in the week of October 19th, net redemptions from the whole Fidelity group were just 2% of its total assets.

Like Wall Street firms, Fidelity laid off staff earlier this year—800 people, 11% of the total. It has also halved its advertising budget, the simplest and easiest cost to cut. That has worried some of Fidelity's managers who fear that Fidelity might be forgotten by many investors when the retail business finally picks up. As one insider says: "When you leave a market, it is almost impossible to go back in."

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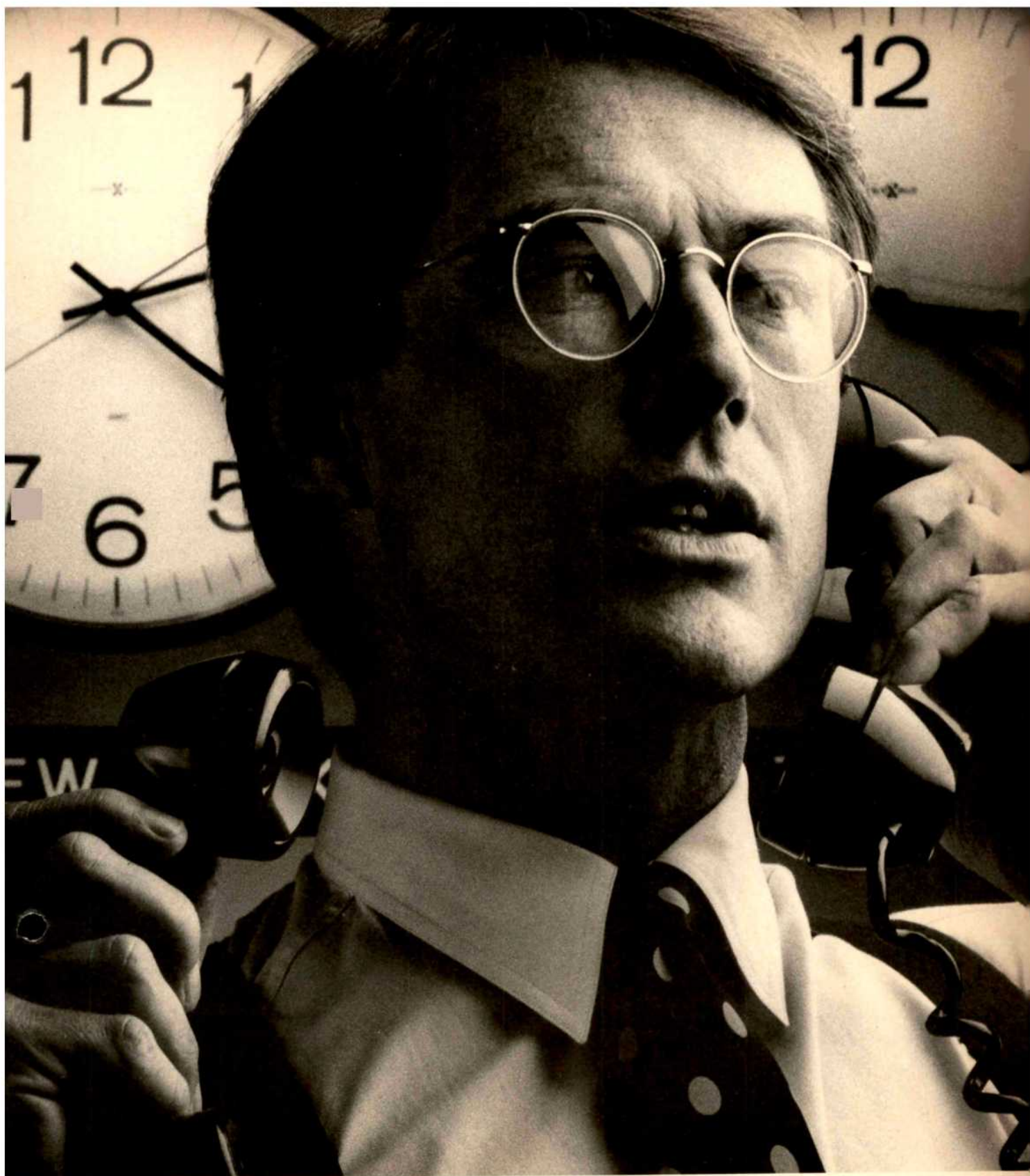
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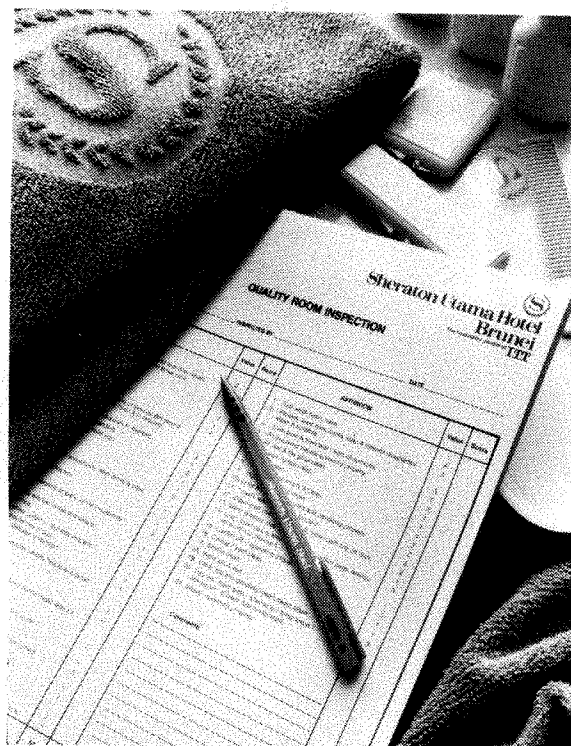
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vices and more imaginative products to an increasingly sophisticated customer. Retirement accounts (in Britain, personal pensions) are a clear candidate. Merrill Lynch has pushed into that area and is building up its insurance business.

These kinds of products help breed customer loyalty, important since one in every two investors in America has an account with at least two brokers. Yet other areas, for instance mortgages, have barely been touched. Shearson Lehman Hutton is just starting to market them. With some 2.2m accounts, it controls \$155 billion of its customers' money, or just under half of the customers' liquid assets. But those clients are also borrowers to the tune of \$100 billion, only \$3.5 billion of which is lent by Shearson.

Before these brokers can succeed, they will have to shed a lot of old habits and their high-cost structures. Merrill Lynch, the lumining herd, grew throughout the bull market by adding more brokers to its network. More brokers equals more business equals fees? Not always. Merrill ignored the expensive hotch-potch computer systems and cumbersome middle-management needed to

support its 13,000 broking army. Shearson Lehman Hutton is better placed: it has a leaner style of management and a state-of-the-art computer system—one reason why it could absorb E.F. Hutton and lay off most of that firm's back-office.

Other firms need to cut back on staff and refine their computer and management-information systems. The lesson still seems lost on Wall Street. Old-fashioned individual brokers (ie, salesmen) remain its hottest commodity. A fierce battle is being waged amongst firms keen to grab their rivals' brokers and to hang on to their own, a fight sparked by Shearson's acquisition of Hutton. Firms like Paine Webber and Prudential-Bache are offering immediate bonuses of up to 40% of brokers' 1987 pay to persuade many of Hutton's original 6,000 brokers to jump ship. At present, a quarter of Wall Street's brokers change firm each year; half of these have less than five years' experience.

These antics are against the best interests of the firms involved because they will add to already-high costs without necessarily bringing in commensurate revenues. So far, customers have been reluctant to follow

their brokers to a new firm because their money is often tied up in in-house funds. Such shenanigans also work against customers' interests: broking houses say they want to give better service, but how can they with firm-hopping staff?

Interest rates

When good news is bad

AMERICA'S financial markets are hard to please. Last month, news that America's trade gap had widened to \$13.8 billion in February sent share prices and bond prices tumbling. So the latest figures, which showed that the deficit had narrowed to \$9.7 billion in March (see page 73), should have cheered the markets. Instead, the prices of both shares and bonds perversely tumbled. Bond yields surged to their highest level for more than five months. The thinking seems to be that good trade figures confirm a rapidly expanding economy. Infla-

Worthwhile accountancy initiative

NEARLY three centuries after the Act of Union joined England with Scotland, British accountants are preparing to follow suit. On May 17th the council of the Institute of Chartered Accountants of Scotland finally accepted a proposal to merge with the Institute of Chartered Accountants in England and Wales. The new "British institute" will come into being in five years. But hopes that British accountants are at last showing an appetite for reform are a little premature.

The new plan has taken six months to draw up—which, by accountants' standards, means overnight. It is also simple. The English Institute, which has 87,000 members, will in effect absorb the 12,000 members of the Scottish institute. London will take responsibility for regulation, public affairs and relations with the government. Edinburgh's only big responsibilities are education, training and research.

Merger of the two institutes is long overdue. Accountants north and south of the River Tweed follow the same rules and do the same jobs, frequently in the same firms. The minor differences between English and Scottish accountancy law (mostly to do with property) affect only the final stages of an accountant's training: the rest can be done together. A joint institute will mean no more embarrassing muddles where the two institutes have dis-

agreed—for example over advertising and incorporation. As the plan admits, "two sources of advice have inevitably meant a loss of impact for the profession."

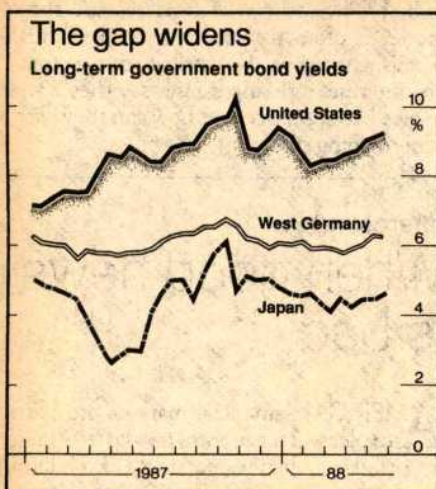
The Thatcher government's impatience with this dithering has been one spur for change. Recent laws like the Insolvency Act (1985) and the Financial Services Act (1986), as well as the government's proposals for implementing the European Community's Eighth directive,

have all treated British accountants as one body anyway. The big international accountancy firms are also fed up with the present division. They waste time and money putting recruits through two near-identical but nevertheless separate training systems.

However, small accountants seldom like big change. So the plan could yet be thrown out when it is put to a vote of the members of the Scottish Institute sometime next year. Only about a quarter of the members work as auditors. The other 9,000 either work in industry or have retired. Some Scots rebels, backed by Scottish newspapers, still hope that these backwoodsmen will reject the plan. Nationalists argue that if there has to be a new British institute, it "could and should be based in Scotland, the home of the first institute."

Even if the plan survives this Celtic fusillade there will still be five institutes of accountants in Britain, compared with two in France, two in Germany and one in Holland. The other three institutes representing public-finance accountants, management accountants and certified accountants will probably only agree to share some training with the new British institute. And, whatever structure the institutes adopt, a host of other anachronisms—such as the lethargic standard-setting system—will remain.





tion, therefore, is deemed a threat.

American long-term government bond yields have risen from 8.3% in February to 9.3%. Yields have also edged up in West Germany (from 5.9% to 6.3%), and in Japan (from 4.1% to 4.7%). The common cause is the fear of higher inflation. America is right to be worried: the various measures of money have accelerated sharply this year, reflecting the Fed's easing of credit at the end of last year; the economy looks close to full capacity; and the labour market is becoming tight. America's inflation rate is widely expected to rise from its current rate of 3.9% to 5-6% by December.

At this week's annual meeting of OECD ministers in Paris, Mr Nigel Lawson, Britain's chancellor of the exchequer, warned that inflation was a bigger threat to the world economy than recession. In particular, he sees dangers in the strength of demand in America. Maybe his now infamous comments to the Wall Street Journal on the possibility of an international rise in interest rates were not so hypothetical after all.

The Fed's recent tightening, which pushed the Fed funds rate above 7% and prompted banks to raise their prime rates by half a point, knocked on the head the theory that the Fed could not raise interest rates in an election year. In fact it did exactly the same in 1980 and 1984.

Outside America, fears of inflation seem to have been exaggerated. Inflation is still running at only around 1% in Japan and West Germany. The previous concerns of their central banks about rampant monetary growth may now be easing. The 12-month growth in Japan's M2+CDs measure of money slowed slightly in March, though it still grew by a heady 11.8%. West Germany's M3 rose by 6.1% in the same period—a whisker above its target of 3-6%.

The dollar remains the key to international bond yields. The news that America's trade deficit had narrowed pushed the dollar to its highest level against the D-mark for three months. But despite the improvement the trade deficit still looms large, and nasty

figures in future months are almost inevitable. Although on most estimates the dollar is now close to its "correct" level, this will not itself guarantee stability. The fate of the dollar depends primarily on America's ability to attract a net inflow of capital.

Although yield spreads have widened a touch in favour of the dollar this year, they still remain well below previous peaks. And as American inflation heads for 5% or more, yields of around 9% hardly look excessive. On top of this is the uncertainty over the result of the presidential election and the likely consequences for the economy, which may lead investors to demand a risk premium. Either yield differentials must widen in favour of the dollar, or the dollar must fall. Probably both. Some of Wall Street's money men are betting that yields could hit 10% within three to four months.

Europe's single market

After the bankers' siesta

MADRID



The single European market is concentrating the minds and assets of Spain's bankers. Following the merger of Banco de Bilbao and Banco Vizcaya in January, the betrothal is now announced of Banco Central and Banco Espanol de Credito (BANESTO), the country's biggest banks. The latest merger will take three years to complete (just in time for 1992) and will spawn a new bank, Banco Espanol Central de Credito, with Ptas 5.4 trillion (\$49 billion) in assets. It will also be Spain's biggest private industrial holding company, with stakes in electricity utilities, petroleum refining and construction.

Spain needs to rationalise its banking system if it is not to be swamped or swallowed by more efficient foreign banks in 1992. Although Spain is wildly overbanked—there is one bank branch per 1,200 head of population—it is a lucrative banking market. Spanish banks enjoy the highest interest rate margins of all OECD countries—4.9% compared with Britain's 3.6%.

The merger of Central and BANESTO is more of a shotgun marriage than the authorities would have liked. Two months ago Spain's socialist government was backing a merger between Central (the biggest bank) and Banco Hispano Americano (a well-managed bank which is also the country's third biggest). In March negotiations broke down between the two because of a disagreement over share valuation.

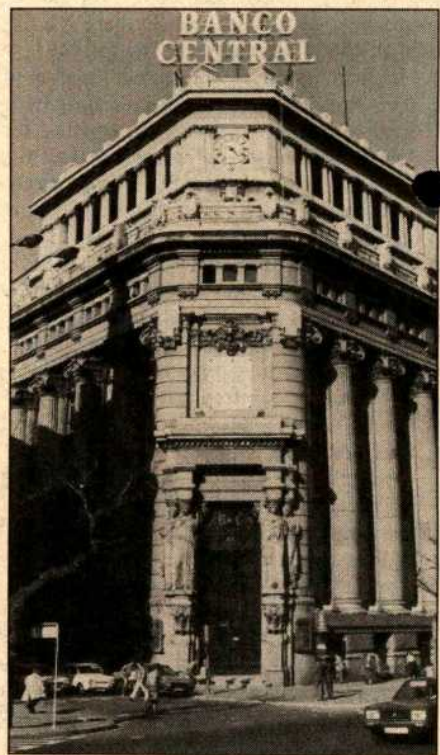
The authorities have long wanted to ginger up Central, which they believe has

been badly managed. They first tried to apply the ginger through Central's main shareholder, Cartera Central. This holding company was formed last December when the government took fright at the 5% stake in Banco Central held by the Kuwait Investment Office. The Kuwaitis were effectively strong-armed into dumping their shares into the new company, in which a Spanish property company, Construcciones y Contratas, has a 51.8% stake and the Kuwaitis the balance. Under the terms of the holding company agreement neither partner can buy shares in Banco Central independently. The holding company, in turn, owns a pivotal 13% in Banco Central.

Attempts by Cartera Central to put directors on Banco Central's board were resisted by Central's authoritarian chairman Mr Alfonso Escamez. Cartera Central showed signs of impatience the week before the BANESTO merger. It said that it was going ahead with a 50% (Ptas 20 billion) capital increase to buy more Banco Central share.

Mr Carlos Solchaga, Spain's economy minister, told Cartera Central that it could not increase its stake to 15% or more of Banco Central without first getting the approval of the Bank of Spain, the country's central bank. Such authorisation is required by a government bill that is due to be approved in parliament shortly. But when the merger was announced, Mr Solchaga asked Cartera Central not to block it. The deal will leave Cartera Central as the biggest shareholder in the new group with 7.5% of the equity.

Mr Escamez will be chairman of the



Betrothed by shotgun

holding company which will supervise the deal. His number two will be BANESTO's biggest shareholder and chairman Mr Mario Conde. He has been a banker for only 8 months and will become chairman when the septuagenarian Mr Escamez retires.

Spain's need for a bill to give the Bank of Spain the power to vet stakes in Spanish banks became apparent in early May; then the government discovered to its horror that Deutsche Bank had gained control of the medium-sized Banco Comercial Transatlantico on the sly. Deutsche was ordered to unpick the deal, and Banco Comercial's access to the Bank of Spain's discount window was closed.

The new Banco Espanol Central de Credito will start life with big handicaps. Central and BANESTO have the highest running costs of the big Spanish banks—and Spanish banks have the highest operating costs in the OECD because they have so many inches and employees. Both banks have missed the banking unions that the merger will not mean cuts in the 4,340 branch network or in the workforce of 35,000. That is tantamount to a promise that they will stay inefficient.

Capitalism

BRUSSELS



The common market is unlikely to get a central bank, let alone a single currency, by the end of 1992. But the chances are that capital flows between the majority of members will be free by then. This would be a modest achievement, and, for half the members, means practically nothing. Britain, West Germany, Holland and Denmark have no capital controls left; and the Belgians and Luxembourgers have almost dismantled theirs. It is the other six members who need to make an effort.

France and Italy have relatively few major controls compared with the poorest EEC countries—Ireland, Greece, Spain and Portugal. The French and Italians are therefore most likely to accept the set of liberalisation measures due to be agreed by the Twelve next month, and implemented within a movable timetable. In principle these measures, contained in three separate pieces of legislation, lift the last capital restrictions still permitted by the Community. These are on short-term financial operations not linked to trade transactions or direct and equity investments, and on the opening of bank accounts by EEC citizens in a country other than their own.

The liberalisation package will give Community countries until 1990 to lift their restrictions. Only France and Italy are ready

to accept the deadline. Spain wants a delay until the end of 1992, as do Ireland and Greece, while Portugal feels it cannot comply before 1994. The latter four are likely to be exempted from the directive until 1992.

The Twelve are also preparing to adopt a new regulation on financial support for members who are in balance-of-payments difficulties or who have problems as a result of free capital movements. The amount available will be 16 billion ecus (\$20 billion), of which 14 billion ecus may be raised by the Community on capital markets for relending to needy members.

The Community also wants to be able to take common action in the event of external monetary pressures. France and the European Commission want a rule that would require banks to limit their currency exposure under certain circumstances to be included in an existing directive on capital movements. But Britain, Germany and Holland feel that, once capital controls are lifted, the dollar and yen should flow as freely in the liberalised market as EEC currencies. They say that any action should come at G7 level. They are just willing to accept a general reference to common action, without the specific commitment sought by France and the commission, providing this is set out not in a directive, which is legally binding on EEC governments, but in a recommendation, whose only force is moral.

The package does not deal with tax evasion or the problems of banking supervision, although both are regarded as vital flanking measures for capital liberalisation by several governments. Banking supervision is the subject of a separate draft directive to be discussed by ministers in coming months. Proposals are still to be formulated to ensure that the lifting of exchange controls does not lead to even more tax evasion in countries like France or Italy, where it is endemic.

Other ideas under discussion by ministers include the harmonisation of withholding taxes charged by member governments on dividends and interest payments; the requirement that banks disclose information on clients' foreign transactions; and greater cooperation between national tax-gatherers.

The capital liberalisation measures are a necessary step towards the creation of a single EEC market by the end of 1992. They are a prerequisite, for instance, for the freeing of financial services in the Community. The lifting of capital controls will put more pressure on EEC countries to keep their monetary and economic policies more or less in line in the run-up to 1992. Capital will soon flow out of countries rash enough to try to reflate on their own. There will be a relaunch of the debate on how to reinforce the European Monetary System by:

- Getting Mrs Thatcher to let sterling join.
- Creating a better balance between strong

and weak currencies in the intervention system.

- Reducing the permitted fluctuation of the lira from 6% to 2.25% like the rest.

First things first, say the optimists. Central banks and single currencies may come later. Pessimists note that, just as this debate heats up next month, France may be electing a wholly Socialist government.

October crash Bull

NEW YORK

THE presidential working party on financial markets, set up in March to investigate last October's crash, has done its best to do nothing. Its interim report, published this week, contains only one concrete proposal—a one-hour halt in trading in shares, options and stock index futures any time that the Dow Jones industrial average falls 250 points in a day; should the Dow plunge 400 points, the halt would last two hours. Only once has the Dow fallen more than 250 points in a day—on October 19th.

The trading halt, which if triggered will be enforced by the various exchanges, is the panel's one major concession to proposals made in January by the Brady presidential task force's report on the stockmarket crash. Brady recommended cross-market "circuit breakers", which is just a complicated way of saying trading halts. Otherwise the working group—comprising Mr George Gould (under-secretary for finance at the Treasury), Mr Alan Greenspan (chairman of the Federal Reserve), Mr David Ruder (chairman of the Securities and Exchange Commission)



Braking the bad news

FINANCE

and Mrs Wendy Gramm (chairwoman of the Commodity Futures Trading Commission)—remains true to its predominantly free-market instincts. The only dissenter was Mr Ruder.

The interim report endorses present margin levels in both the share and futures markets. It also calls it "unrealistic (and perhaps counterproductive) to try to undo the changes in the financial markets or market strategies brought about by improvements in telecommunications and computer technology." This suggests support for the role played by financial futures and program trading, in the sense of index arbitrage between the share and futures markets.

Mr Gould, the chairman of the working

group and also a former chairman of Wall Street investment bank Donaldson, Lufkin & Jenrette, dismisses suggestions that investors have fled the stockmarket because of techniques such as program trading. He argues that trading volumes always fall after a crash, simply because investors are scared away. That nervousness will only disappear with the passage of time, which is why Wall Street faces more retrenchment.

The working group was even half-hearted about its main proposal—the trading halt after a 250 point drop. Mr Gould says: "No one likes that proposal. Hopefully it will never be tripped." Hopefully not. But presumably he and his colleagues felt they had to do something.

Employee share ownership

The Tortoise and the Bus

IT IS not often in British politics that both socialists and Thatcherites can agree that a new form of ownership is a good thing. But Employee Share Ownership Plans (ESOPs) seem to appeal to both camps—whether as "popular capitalism" or "social ownership". About 7m Americans work in companies with ESOPs, while in Britain less than a dozen firms have tried them. Although Britain's tax law provides none of the breaks that have nurtured employee share ownership in America, the idea is taking root. This week, MFI, a furniture retailer, set up a plan to give its workers a 5% stake in the business.

Companies with ESOPs do not become worker co-operatives. They remain joint stock companies, so they do not suffer from the inability which co-ops have to raise fresh capital. Nor does an ESOP prevent a company from being managed much like any other. But a successful share ownership plan can motivate a company's workers, through giving them a stake in their firm's growth and profitability.

Typically, such a plan involves a private company setting up a trust. With borrowed money, the trust buys, say, 20% of the company's equity—either new shares or from existing shareholders. The company agrees

to make regular payments to the trust, with which the trust repays its loan. As the trust's indebtedness is reduced, it distributes free shares to the workforce.

If they leave the company, workers can sell their shares back to the trust, at an estimated market value. So staff can realise capital gains without the company needing to be floated. The trust holds its shares in the interests of employees; the workforce may elect some of the trustees, and the trust may have the right to appoint some of the company's directors.

By offering a direct stake in the firm rather than just a profit share, ESOPs encourage workers to take a long-term view of investment decisions. The ESOP structure also allows companies to raise fresh capital: the trust can borrow a second time and buy more shares from the company or its private owners.

Britain's first ESOP was set up by Roadchef last year, when a trust bought 12.25% of the motorway caterer's shares. In March this year, the trust bought a further 15%. Unity Trust Bank, which is 70%-owned by trade unions and specialises in ESOPs, has lent £1.3m to the Roadchef trust. The trust has already distributed 5.6% of the company's share capital, but workers have to leave their shares in the trust for five years to avoid income tax on them. Workers cannot sell shares back to the trust until they leave. Mr Timothy Ingram Hill, the managing director, says that management is paid to manage and that Roadchef's philosophy is not to have worker directors. One of the five trustees is a worker representative although the trust does not appoint any directors.

Companies can tailor their ESOPs to allow any degree of worker share ownership and any degree of worker control. People's Provincial Buses, which covers the South-

ampton and Portsmouth area, picked a more socialist model. As a result of the deregulation of bus routes, early in 1987 this subsidiary of the National Bus Company faced acquisition from a competitor it did not like. So 230 staff put up £750 each to take 20% of the equity, while an ESOP (financed again by Unity Trust Bank) bought 80%. As profits are fed back into the trust, it sells shares to workers and reduces its own stake.

Mr James Freeman, the managing director, says the trust may choose to keep more than 51% of the equity. "This indirect but collective control over management may be more effective than unfocused direct ownership," he says. Workers elect three of the seven ESOP trustees. The trust appoints the firm's directors. Performance of the bus company has improved sharply during the first year of the plan: strikes have stopped, customers are making fewer complaints, a long decline in passenger miles has halted and in the first two months of this year profits after tax of £53,000 (\$94,000) were 50% up in 1987.

The biggest blockage to more British employee share ownership plans is the unfavourable legal environment. The law does not recognise ESOPs. To obtain tax relief on their payments to an ESOP, British companies have to create two separate trusts where one would do in America: an Employee Benefit Trust to borrow money and buy the shares, and a Profit Sharing Trust to receive the company's contributions, buy shares from the benefit trust and distribute them to employees.

In America, the law is less hostile. Banks which back ESOPs receive tax relief on half their interest income from the trust; in Britain, they do not. In Britain a family selling out to an ESOP may have to pay 40% capital gains tax, yet if its stake is acquired through an exchange of paper, the tax can be rolled over.

More companies are likely to follow the MFI plan, the biggest ESOP launched in Britain. It will give the 6,000 staff a 5% stake in the company, which was spun off from the Asda superstore group last year in a £717m management buy-out. The London bit of America's Chemical Bank, which is financing the MFI plan with a £11m loan, is making



Lawson's Pyrrhic victory

Britain's prime minister has bowed to pressure and to her chancellor by patching up their public quarrel over interest rates and the pound. Unfortunately the economic damage cannot be so easily mended

AS SOON as unanimity between Mrs Thatcher and her chancellor, Mr Nigel Lawson, broke out on May 17th the financial markets began to refocus their anxieties about British monetary policy. For the past two months the consensus in the City has been that Mr Lawson was right to link sterling to the D-mark, and that the prime minister was wrong to break that link by refusing to let interest rates fall. Now she has backed down. The Bank of England signalled a half-point cut in the banks' base rates; sterling's rise was (perhaps briefly) interrupted. Promptly, some of Mrs Thatcher's critics are having second thoughts.

Their doubts centre on the growth of demand in the British economy, and above all on the force that is driving it: bank and building-society credit. These two sorts of lending added up to £18 billion in the first quarter of this year, a rise of nearly 70% over the same period of 1987. Much of the money was lent to house-buyers, but that offers small consolation to those who fear an upturn in inflation. Lending for house purchase on this scale will keep house prices soaring. This in turn, according to recent evidence, may add to upward pressure on wages. In any case it is well known that mortgage lending leaks copiously into higher consumer spending, and thus helps to push up demand and prices beyond the housing market. Judged in this light, Mrs Thatcher's reluctance to cut interest rates seems far from crazy.

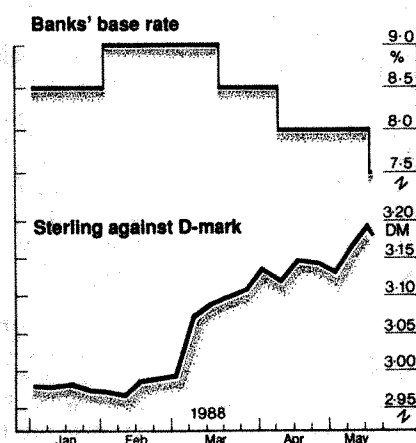
Her reconciliation speech this week pointed out that the recent rise in sterling (first helped on its way by remarks she made before the budget in March) had itself tightened what the Treasury calls "monetary conditions". On that view there could have been scope for base rates to fall another half point while leaving the overall stance of monetary policy suitably restrictive. Since the beginning of March banks' base rates have fallen from 9% to 7½%; over the same period sterling has risen by 6% against the D-mark (see chart) and by 5% in trade-weighted terms. This shift in the monetary mix has left the stance of policy roughly neutral—over a period in which evidence of excessive growth in demand has been piling up.

In its recent bulletin, the Bank of England put its finger on the dilemma that underlies the present confusion over policy. The prospect of a widening external deficit points to the dangers of letting sterling

MARKET FOCUS

rise: a stronger pound will eventually prove unsustainable, and meanwhile it will damage the competitiveness of Britain's exporters. On the other hand, rapid credit growth and the buoyant domestic economy point to the need for higher interest rates. The trouble is that you cannot raise interest rates to curb demand without also causing the pound to rise.

This dilemma is not new, nor should it come as any surprise. Many commentators, including this newspaper, warned that it was looming before the budget—for that was when the opportunity to forestall the present distress was missed. Put



simply, if governments have two economic goals in mind—in this case, non-inflationary growth in demand together with exchange-rate stability—they need two policy levers.

The most direct and therefore most plausible combination of levers is to assign fiscal policy to the task of curbing demand while using monetary policy (ie, interest rates) to keep the currency steady. Signs of over-rapid demand growth were clear to see last March, but instead of tightening fiscal policy in his budget Mr Lawson left it broadly unchanged—or, some would say, even loosened it somewhat. This fiscal lever is now more or less stuck until the next budget. Interest rates have therefore been left to take the strain both of inflation worries and of concerns that an over-shooting pound will inflict all sorts of damage on the real economy.

This dual role for interest rates makes forecasting their likely path—or that of

sterling—much less certain than it should be. Financial markets have a bad habit of translating uncertainty into volatility. Mr Lawson's so-called victory over Mrs Thatcher has done nothing to clarify matters. Will any renewed upward pressure on sterling be met by another cut in interest rates? Or will further evidence of excessive growth in domestic demand mean higher interest rates, even at the expense of a rise in the pound? For all the cabinet's new-found unanimity on monetary policy, the markets have no choice but to wait and see.

Credibility counts

Mr Lawson is thus partly to blame for the recent mess, because he embarked on a policy (exchange-rate stability) which he then left himself inadequately equipped to carry out. But Mrs Thatcher's mistake—though prompted by worries about inflation that deserve to be taken seriously—was much worse.

Faced with the present policy dilemma, and taking fiscal policy as fixed, the best course was arguably Mr Lawson's first choice: retain the link with the D-mark as a credible backstop against higher inflation, and be ready to defend it with higher interest rates when the markets turn against the pound (as they eventually will, if there is any substance to the inflation threat). Failing that, signal the intention to let sterling rise as it now has, but within the context of a coherent exchange-rate policy. Let the markets conclude, in other words, that the target D-mark rate was deliberately shifted to take account of inflationary pressures. At worst, this might have delivered roughly the same mix of interest rates and sterling appreciation as did Mrs Thatcher's intervention, but without creating the impression that the government's entire approach to exchange-rate policy had been overturned.

Does it matter to make a good impression? Yes, because credibility is the government's most important ally in providing financial and economic stability. Without it, its actions in financial markets (for instance, on interest rates or in foreign-currency intervention) may be ignored or discounted. In the same way, credibility makes economic adjustment smoother in the real economy too. If the government says that it will keep exchange rates steady—and is believed—it will need to lean on its policy levers that much less to make its promise come true. That is why in the past two months Mrs Thatcher has done great and lasting harm to her government's economic policy.

FINANCE

a big push into the British ESOP market. Unity Trust Bank also plans more. It has nearly 20 in the pipeline. At the head of the queue is Tullis Russell, a 200-year-old manufacturer of high-quality paper in Fife, Scot-

land. This family firm, which made pre-tax profits of £6m last year, plans to add an ESOP to an existing scheme whereby it distributes annually 7.5% of its profits to workers as shares.

Dai-ichi Kangyo Ace of hearts

TOKYO

"THE BANK with heart", Dai-ichi Kangyo (DKB), has toppled Fuji Bank from the number one spot in Japan's bank-profit league (see table). But DKB still has much to do if it is to overhaul the patrician Fuji Bank on one important measure by which it remains top, profitability (ie, return on assets). And it has another battle on its hands keeping at bay the feisty Sumitomo Bank, which is now recovering fast from digesting the troubled Heiwa Sogo Bank, bought in 1986. Those tasks will fall to Mr Kuniji Miyazaki, who takes over as president from Mr Nobuya Hagura next month.

Making profits akin to those of their international rivals has become the aim of Japan's commercial banks. This is new. They long sought size first, profit second. Size came easily thanks to Japan's huge savings and compartmentalised financial system. Now deregulation, and foreign pressure to raise their capital ratios to international standards, are making the banks squeeze better returns from those assets. That means taking more risk than they are accustomed to and deploying non-banking skills that have long been redundant.

Dai-ichi Kangyo's way of coping with these changed circumstances has been much the same as its rivals, though pursued less

flamboyantly. It has cut costs and shed 5,000 jobs over the past ten years. It has sought more smaller companies as clients (using its ties with Fujitsu and the 47 other companies belonging to the Sankin-kai industrial group). Individual customers (of which it has 20m, more than any rival) have been actively wooed. Its network of 360 branches, two-thirds of them in the greater Tokyo area, is the largest of any commercial bank. That gives it an edge over rivals. Retail deposit gathering is the most attractive source of cheap funds as Japan deregulates interest rates on large pools of savings.

The bank has also diversified into foreign-exchange and bond trading, though less fiercely than its rivals. Both of these new businesses account for a smaller percentage of its recurring profits (around 4% each) than the average for the big five commercial banks. Interest income still accounts for more than 85% of its recurring profit. DKB is the world's biggest retail bank, and it plays a bit unimaginatively to that strength.

DKB's international expansion has been cautious. Though it has an estimated 30% of its assets abroad and derives 20% of its gross profit from them, it is a rarity among Japan's leading banks in not having made a big American acquisition. Its exposure to third-

leading banks in not having made a big American acquisition. Its exposure to third-world debt, at ¥406 billion at the end of last September, was only 0.89% of total assets; that is well below the average of 1.29% for Japan's 13 largest commercial banks.

By comparison, its lending into Tokyo's property boom looks reckless. At the end of last September, loans outstanding to property firms were equivalent to 179% of its shareholders' equity. Yet even that is below the average for the 13 big commercial banks, and it accounts for less than 7% of all DKB's loans. (As with all commercial banks, that figure should be trebled for a truer picture.)

A warning of the risks of lending to an overheated property market came in February. A (now ex-) manager at its Kojimachi branch in Tokyo was found to have taken ¥100m in gifts from a property developer, in return for unauthorised loans that has cost

All change

Pre-tax profits, ¥ billion (March '87 ranking in brackets)		
Rank	Mar'88	Mar'87
1 Dai-ichi Kangyo (2)	295	205.9
2 Sumitomo (4)	288	181.1
3 Fuji (1)	284	218.8
4 Mitsubishi (3)	282	194.0
5 Sanwa (5)	264	180.1

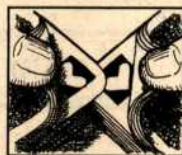
Source: Nihon Keizai Shimbun

the bank ¥3.6 billion.

DKB, which is still seen as a parvenu in the aristocratic world of Japanese banking, labours under one shadow that does not cloud its rivals. It was formed from an equal merger in 1971 of the Dai-ichi and the Nihon Kangyo banks. It has not yet fully integrated the management of the two banks. The current chairman, Mr Tetsuo Fujimori, is a Dai-ichi man; his successor in June, Mr Ichiro Nakamura, is from Nihon Kangyo.

All big Japanese companies find mergers difficult. The lifetime employment system imbues strong corporate cultures that do not mix easily. But the divide seems to have lingered uncommonly long at DKB, and has harmed the bank's efficiency. Deposits and loans per employee and per branch are still weak. Earnings per employee are only two-thirds of those at Sumitomo Bank.

Mr Miyazaki's main task will be to use DKB's huge assets to squeeze out more profit. He is a domestic banking specialist, and has a reputation as a skilled political operator inside and outside the bank. He is well connected at the Ministry of Finance. He will need all these attributes. DKB's capital ratio is far too low, and Herculean efforts will be needed to raise it. The battle between the commercial banks and the securities houses promises to be bloody, as the walls separating commercial and investment banking crumble. DKB does not want to end up with a bleeding heart.



Out goes Hagura...



and Fujimori too

SCIENCE AND TECHNOLOGY

Not another genetic code . . .

A SECOND genetic code it is not. But a discovery announced last week does begin to clear up the biggest remaining mystery in the code of life. In all living things, the information encoded in genes has to be translated from the language of DNA—the chemical of which genes are made—into the language of proteins. This takes several steps, one of which involves another cipher of some kind. The location, though not the key, of that cipher has now been discovered.

It is customary, nowadays, for a scientific discovery to be accompanied by a good deal of public-relations hyperbole. Dr Ya-Ming Hou and Dr Paul Schimmel of the Massachusetts Institute of Technology were ensured front-page treatment when somebody (not they) coined the phrase “a second genetic code” for what they had found. Later newspaper reports, especially in America, swam with vague predictions of the medical and industrial breakthroughs that would follow. But the notion of a second code is misleading, for it implies a genetic code entirely separate from the first one—a different way of building bodies. No wonder some scientists were puzzled by the news: why do we need another code, they asked, when the first one works perfectly well? None the less, this code is an integral part of the mechanism for deciphering the first one.

An analogy may help. A gene is like the instructions for assembling a watch, written out as a list of the parts in the order in which they must be added to the growing whole. A person reading the instructions takes each part in turn and puts it into the watch: first a spring, then a cog, then a lever, and so on. The parts are in boxes, each box being clearly labelled: cog, spring, lever, etc. Genetic instructions are written in the four-letter alphabet of DNA in three-letter words, giving 64 kinds of words. The parts are amino acids, the building blocks from which proteins (watches) are made. Each word—and each label, which is a translation of the word—specifies one amino acid.

This much has been known since around 1955, when Dr Francis Crick predicted the existence of the boxes in which the parts were stored. He called them adaptor molecules; they are now dubbed transfer-RNAs. A nagging difficulty with this pic-

ture has been known for almost as long. Scientists soon realised that there was a problem about how parts managed to end up in the right box.

Transfer-RNA (or tRNA) is a small strand of RNA (a cousin of DNA), folded into a shape like a clover leaf. At the top of the middle lobe of the leaf is a string of three letters (or nucleic-acid bases) which can be thought of as the label on the box. At its stem is an amino acid: a lever, cog or spring. Yet, oddly, all amino acids (parts) are attached to the tRNAs (boxes) by identical links. There must be some mechanism which ensures that each amino acid gets attached to a tRNA with the appropriate label. Put the wrong parts in the wrong boxes and you would get a mess instead of a watch.

It is that mechanism which is now starting to emerge. The most obvious mechanism would be for the enzyme that attaches the amino acid to the tRNA to take note of the label (or anticodon, as it is called). But this is too neat a solution for nature's Rube Goldberg/Heath Robinson predilections. Two years ago scientists at the California Institute of Technology in Pasadena proved that one type of tRNA could be turned into another without changing its anticodon label. Instead, they changed a series of 12 bases elsewhere in the molecule. In other words, they managed to make a different part go into the box without changing the box's label.

Dr Hou and Dr Schimmel have pinned



down the two bases that determine which amino acid gets put into one sort of box, or type of tRNA. The tRNA that carries an amino acid called alanine has a letter G (a base called guanine) at position 3 and a letter U (a base called uracil) at position 70. If either of those bases is changed, it no longer carries alanine. More revealing, if two other kinds of tRNA are given G at 3 and U at 70, they too become alanine carriers. Dr Hou and Dr Schimmel concluded that this pair of bases is enough to tell the enzyme that fixes amino acids on to tRNAs that a molecule should have alanine attached—whatever the label on the box might say.

Alanine is one of 20 amino acids in the protein alphabet. So the MIT scientists have deciphered only one of the 20 entries in the handbook of tRNA codes. And it is clear that the other entries will not be confined to positions 3 and 70, for there are (usually) only four kinds of RNA letters and therefore only 16 combinations that can appear in those two locations. Besides, the scientists already know that tRNAs carrying different amino acids sometimes have the same pairs of bases at 3 and 70.

None the less, Dr Hou and Dr Schimmel have for the first time cracked an element of this code. As Dr Christian de Duve, director of the International Institute of Cellular and Molecular Pathology in Brussels, wrote in *Nature* last week, several features of the code are already apparent. In particular, because there is only one kind of enzyme for attaching each kind of amino acid to the right tRNA, the code does not include redundant features as the main code does—where, in some cases, more than one anticodon specifies the same amino acid.

Dr de Duve believes that the new code may be more primitive than the code used by genes themselves and may have developed earlier in the history of life. This fits with the notion that RNA is a more primitive version of DNA, from which it differs mainly in being incapable of forming a double helix. DNA, partly because it can twist into the tidy double helix, is a more stable structure than RNA, more resistant to accidental alterations. Some viruses still use RNA for their genes; but in higher animals, DNA has largely replaced it for the permanent hard copies of genes—just as steel replaced pig iron 100 years ago because it is more durable. RNA, meanwhile, is still used for the temporary copies of the genes used to translate the code into protein: transfer-RNA is one example of this. It is also the critical link between the new code, now being cracked, and the old one, cracked in the 1960s.

The new code will not have any immedi-

ate applications. The medical implications are not thrilling. If it turns out that some genetic disease is caused by a hereditary mistake in part of the new code, then it should soon prove possible to identify carriers of the faulty tRNA gene, though not necessarily to cure them. But such mistakes, if they made tRNAs pick up the wrong amino acids, would probably be far too damaging for their carriers to survive, so scientists are unlikely to find such errors.

The implications for genetic engineering are not too promising either. A genetic engineer can already assemble amino acids to make proteins in any order he wants. He can also alter a gene to substitute one amino acid for another by changing the ordinary code. He does not need the new code for anything. None the less, it is satisfying to see a piece of the genetic puzzle put into place. And, as Dr de Duve's speculation suggests, the new discovery may shed some light on how a nucleic-acid recipe originally came to be life itself.

Waste disposal

Stinks ahoy

THERE is only one place in the world where chemical waste is regularly burnt at sea: about 100 miles off the north-eastern coast of England. The sea is sacred to environmentalists—more so, if possible, than mother earth herself. So even that isolated waste-burning will probably have to stop by 1994, thanks to an agreement signed by European ministers last year. The victorious environmentalists say that science is clearly on their side. A gathering of experts in London last month disagreed. Science does not grant its favours so lightly.

According to Dr John Parker of Ocean Combustion Services (a subsidiary of an American company, Waste Management), some 110,000-120,000 tonnes of waste are incinerated at sea each year, most of it from West Germany. Ocean Combustion Services operates from Rotterdam and owns the good ship *Vulcanus II*, which does most of the dirty deed. The best sorts of waste to burn—on land or sea—are complex organic molecules made from elements such as carbon, hydrogen and chlorine. Such molecules can be burned in oxygen to form simple, safer ones like carbon dioxide, water and an acidic gas, hydrogen chloride.

There are two good reasons for burning at sea. Nobody wants hazardous waste moved around and burnt anywhere near his own backyard. And some wastes are cheaper to burn at sea: Dr Parker estimates that it costs £100-300 (\$190-570) per tonne. Wastes which produce extreme amounts of hydrogen chloride could cost up to £5,000 per tonne to burn on land. This gas cannot



Not for owls or pussycats

be allowed to escape on land because it would wipe out neighbouring animals and vegetation as it settled. So land-based incinerators use expensive scrubbers in their chimneys to collect the gas and neutralise it with sodium hydroxide. The beauty of the sea is that it is naturally alkaline. So long as no ships are nearby, it can absorb the hydrogen chloride for nothing.

The sea incinerators claim that only around 0.005% of their toxic waste escapes. An environmental group, Greenpeace, say that this figure is wrong, partly because it fails to take the effects of hydrogen chloride into account; and partly because of something that is true for all incinerators, whether on land or sea.

Take the point about hydrogen chloride first. According to research at the Studsvik Institute in Sweden, fragments of waste molecules could, in theory, react with hydrogen chloride in the plume of gases that emerge from a ship's funnels. The products of these reactions would be as deadly as the waste itself. Nobody knows how much of these chemicals get in to the plume because they are too tricky to measure. The incinerators say this proves that they are too diluted to matter. Greenpeace replies that they are absorbed into the microscopic film of organisms which live on the sea's surface and are gobbled into the food chain. The only evidence for this comes from rather tricky laboratory mock-ups.

Greenpeace's other complaint concerns how the efficiency of a burn-up is measured. One of the ways to calculate this figure compares the concentration of a particular waste going into the furnace with the concentration in the emerging gases. Greenpeace says that this method ignores some new compounds that may have been formed inside the furnace. It says that an analysis of the ash left in furnaces reveals traces of them. Those who favour incineration retort that these traces are even fainter than those in ordinary soil.

The proponents of incineration at sea claim that they are the innocent victims of green politics. The British government may well have sacrificed sea-burning in order to be able to keep on dumping waste in other ways. The trouble with Greenpeace's scientific objections—apart from the point that they are largely speculative—is that most of them would also apply to burning on land. Its own answer, storing everything until some other means of disposal turns up, fails to appreciate how nasty some chemical wastes are to have around.

Data compression

Pntng by nmbrs

CANYRD ths sntnc? F crs y cn. In those two sentences, 35 letters-worth of writing are successfully represented by just 20 consonants. Although such "data compression" may be a tiresome trick for every reading-matter, it is a crucial one for computer scientists and generals. Traditional methods can yield compression ratios of up to 10:1 (compared with 35:20 for our opening sentences), which is not bad. One application of the emerging science of fractal geometry lets you squeeze 10,000—perhaps even 1m—computer "words" into one.

The first application of this almost-magical trick is for computer-stored pictures that have been translated into digits. Dr Michael Barnsley and Dr Alan Sloan, at the Georgia Institute of Technology in Atlanta, are working on compression techniques that could be used to store, transmit and analyse images sent down from satellites.

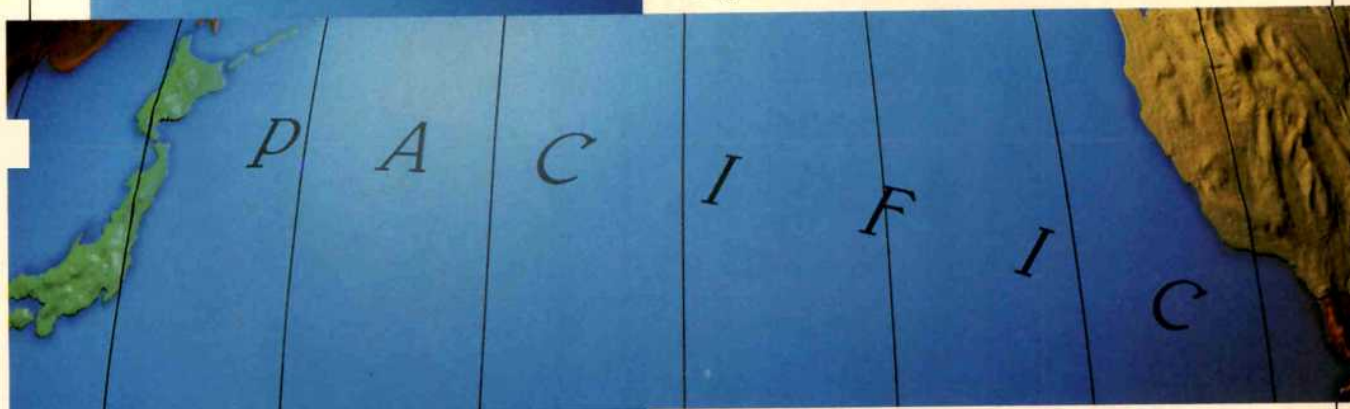
The way it is done can best be understood through the two backbones of fractal geometry—the concepts of self-similarity and of fractal dimension. A self-similar image, or piece of data, is one in which an enlargement of a part looks like the whole.



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WITHOUT US, HO



February 1st 1953 is a date no Dutchman will ever forget.

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Just before dawn, horrified

observers in Zeeland saw the giant sea dyke suddenly bulge and crumble.

By noon, vast tracts of the country were under water. Two thousand people and 250,000 farm animals died.

In the aftermath, it was obvious that massive new sea defences were needed.

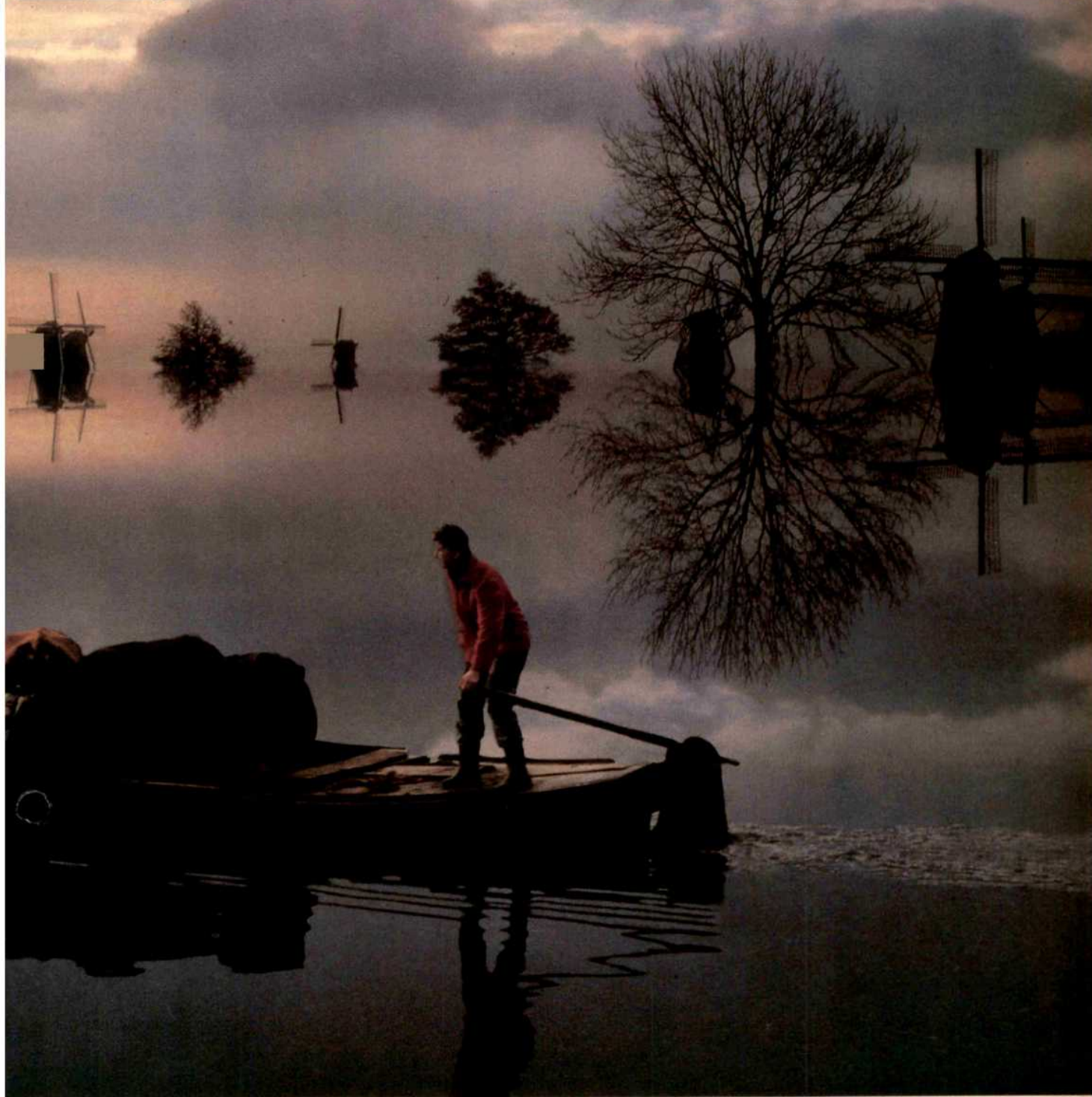
The question was how to anchor them in the treacherous shifting sands.

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HOLLAND'S SUNK.



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Since the smaller part is identical to the whole, the whole can be rebuilt from a part. Thus the data used to describe the whole can be compressed. By how much depends on its fractal dimension.

To understand the idea of fractal dimension, imagine measuring the coastline of a small island with a measuring stick one kilometre long. You swing the stick end over end in a ponderous march along the coast, adding a kilometre with each swing. Many small bays and points will be missed because they are too small, so this way of measuring is not strictly accurate. But nor is any other similar method. Repeating the process with a metre stick would produce a longer measurement. A centimetre stick even more so, and so on. As the stick gets smaller, the length of the coastline increases.

The extent to which the measured length depends on the length of the measuring stick is called the coastline's fractal dimension. A coastline is not a straight line or linear curve (both have a fractal dimension of one) nor is it a plane (which has a fractal dimension of two). Because each crinkle of the coastline has crinkles made of crinkles—hence the problem of measuring accurately—a coastline lies somewhere between the two, rather like a line that is twisting and turning in an attempt to cover a whole surface. A fractal dimension can be thought of as describing the complexity of a shape.

Most large portions of data contain underlying patterns of shapes within shapes—fractals—which, if discovered, can be stored in place of the portions of the images that the data describe. A large library of mathematical functions, called affine transformations, is used to find these fractal keys. The transformations are combinations of rotations, scaling and translations of the coordinates of points of an image. Applied to the data again and again, the transformations progressively squeeze them up by reducing their "scale" until only a few fractal formulas and points remain. When it is time to retrieve the words or pictures, the fractal formulas can be used to generate the data they represent by reversing the affine transformations—backtracking—and using a few stored pieces of data to recreate the rest.

The extreme compression which fractal geometry makes possible should let small computer systems wield enormous amounts of data. Given 10,000-fold compression, anybody with a home computer could store all the main encyclopaedias, a half-century of newspaper and magazine back-numbers, plus a lot more, on a single laser-read disc that costs \$6 to produce. Nt bd.

How soon fractal data compression enters the marketplace will depend largely on computer speed. The huge number of calculations required to compress or blow up data makes it too cumbersome a process for today's personal computers. Even large, uni-

versity computers take ages to do the job. America's defence department is hurrying the work along. The Defence Advanced Research Projects Agency has given the Georgia team a contract to try and speed up the process so it can be used to manipulate and analyse reconnaissance images quickly.

Slimming pills Eureka

A PILL that helps people lose weight, without nasty side effects, has been developed, tested and proved. Yet the British company that invented it, Beecham, has no plans to take BRL 26830A any further. It is looking for somebody else to guide the drug, under licence, through large-scale trials and on to the shelves.

Part of the story of BRL 26830A began in the 1960s when researchers discovered why new-born babies do not shiver when they are cold. They do not need to. When people shiver, their uncontrolled muscular movements produce heat and so keep them warm. New-born babies have another source of heat: cells packed with brown-coloured fat. When a baby is cold, energy from the slow burning of brown fat (whose main job is to help drive growth and movement) goes instead to provide heat.

This led to an investigation of brown fat in grown-ups and a new theory. According to the theory, unwanted food is burnt by brown-fat cells to stop it accumulating. The trouble with people who are naturally obese is that they have to build up a bigger store of fat before their brown-fat cells start to burn it up. So they feel cold and miserable when on a strict diet, because their brown-fat cells are not producing enough heat.

That theory turns out to be only partly right, yet it pointed researchers in a fruitful direction. They tried to find ways to make obese people's brown-fat cells burn up surplus food more effectively. In 1984 a team led by Dr Tony Ainsworth at Beecham's research laboratories in Epsom, Surrey, found out how to do it with some mice, using hormones related to adrenaline. Such hormones make brown-fat cells burn fuel faster, but also have nasty effects on the heart, lungs and other organs. Dr Ainsworth's team developed a set of drugs that stimulate the receptors on brown-fat cells without affecting the receptors on heart and lung cells.

The prototype slimming pill was tested on a strain of obese mice which inherit inefficient brown-fat cells. When given a normal diet, the fat mice on slimming pills either lost weight or gained little. Others from the same strain on the same diet but no slimming pill got steadily fatter.

Some pills based on Dr Ainsworth's prototype have now been tested at the



Inefficient burner and friend

Ninewells hospital in Dundee. A sample of 40 obese people—mostly women and all at least 20% overweight for their height—were split into two groups. Both were given a low-calorie, high-fibre diet for 20 weeks. One group also took BRL 26830A; the others, unknowingly, were given a placebo instead.

People who took the drug lost an average of 15.4 kilograms in the 20 weeks of the study and the others lost an average of only 10 kilograms. In other words, the effect of the drug was nearly half as much again as that of the diet. A few of the people became tremulous; there were no other side-effects.

The drug does not mean salvation for gluttons. The people it could, apparently, help are those who are fat because of the metabolism they have inherited—not people who simply eat too much. Dr Alan Connacher, a research fellow at Dundee University, is trying to find out exactly how the drug works. It is already clear that brown-fat cells are not the crucial thing. Adults have too few of them to burn off a useful amount of fuel. The extra burning stimulated by the drug seems instead to take place in the cells of skeletal muscles.

The muscle cells that are stimulated by BRL 26830A to burn fuel faster do so all the time, not just when the muscles are contracting. And muscle tissue itself does not get burnt. In fact, the drug is so good at making the body burn fat and not lean meat that a related hormone has been developed for use in agriculture—to make beef cattle produce leaner carcasses.

Why, then, is Beecham—whose research team is the furthest advanced of several working on such drugs—merely licensing out the drug rather than selling it itself? The company argues that the number of people who go to their doctors with weight problems that the drug could help is relatively small. Perhaps that it is because in the past doctors have had precious little to offer them.

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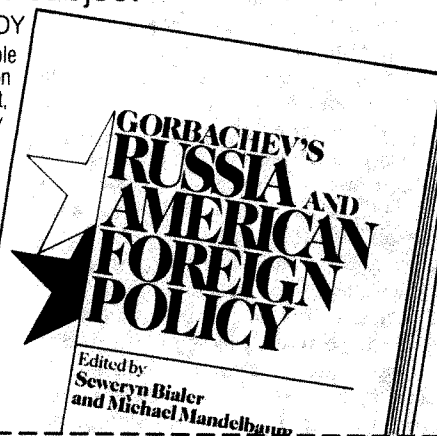
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BOOKS AND ARTS

The pliant Hashemite

COLLUSION ACROSS THE JORDAN. KING ABDULLAH, THE ZIONIST MOVEMENT, AND THE PARTITION OF PALESTINE. By Avi Shlaim. Oxford University Press; 676 pages; £35. Published in the United States by Columbia University Press

WHEN he was a young conscript in the Israeli army, a sleeping Avi Shlaim made the mistake of letting his commander kidnap his rifle. For this delinquency he was sent marching rifleless, and trouserless, across the border into Jordan. It would serve him right, he was told, if the Jordanians shot him. They did not. Indeed, there were no Jordanian soldiers to be seen on Jordan's side of the border, a circumstance that suggested to the young Israeli that there was something a little bit special about the relationship between Israel and Jordan.

In this splendid book the middle-aged Avi Shlaim, still rifleless but now Alastair Buchan Reader in International Relations at the University of Oxford, traces that special relationship to its origins in the crisis in Palestine between 1947 and 1949. His account, drawing from a bounty of official archives recently declassified under Israel's 30-year secrecy rule, breaks up the familiar historical jigsaw and re-arranges the pieces.

The central events of the period are not in dispute. In November 1947

United Nations General Assembly voted to end the British mandate in Palestine, to partition the country into Jewish and Arab states and to internationalise the government of Jerusalem. Six months later Britain's troops pulled gratefully out of a Palestine that was disintegrating into civil war. But no other part of the UN resolution was implemented according to plan.

The fighting between the Jews and Arabs inside Palestine itself billowed into a bigger war between the Jews and the Arab armies of Egypt, Lebanon, Syria, Iraq and Jordan. By the end of the war Israel had occupied far more territory than had been allotted to it under the partition plan. The Palestinian Arab state never came into being at all. Instead, King Abdullah of Transjordan grabbed the West Bank, and half of Jerusalem, for himself.

Historians agree on this bald outline,

but on little else. Zionist historians portray the events of 1948 as the heroic struggle of an Israeli David against an Arab Goliath; Arabs stress the military strength of the Jews and the disunity of the Arab expeditionary forces. In the Zionist version of events, no Arab state ever countenanced the possibil-



Abdullah's eyes were on Syria

ity of living in peace with Israel. The Arabs say that Israel has been consistently more intransigent.

Mr Shlaim is one of Israel's "revisionist" historians. The proposition that no Arabs considered making peace with the infant Israel does not survive his scrutiny. Long before the British left Palestine, King Abdullah saw the importance of an accommodation with the Jews. He did not believe that the Arabs could dislodge the Jewish population by force, and he was anxious to avoid a war in which Transjordan's most precious diplo-

matic tool, the British-officered Arab Legion, might be swallowed up in purposeless fighting. Above all, he wanted to expand the miserable little kingdom Britain had settled on him in place of the Greater Syria he craved. Syria remained Abdullah's ultimate target. A piece of Palestine would, in the meantime, suit him nicely.

Abdullah's ambitions were not only understood by the Jews but welcomed by them. The pliant Hashemite would certainly make a more congenial neighbour for Israel than would a Palestinian state under the fanatical leadership of Haj Amin al-Husseini, the mufti of Jerusalem. A few days before the UN resolution, Golda Meir met Abdullah secretly at Nahariya, on the Jordan river. The king disliked the charmless Zionist from Milwaukee, but they made an unwritten agreement. Israel would not object to the Arab Legion grabbing the parts of Palestine that were supposed to go to the Palestinian Arabs—provided it did not cross into the areas the UN had set aside for the Jews.

The knowledge that Golda Meir conducted a secret diplomacy with Abdullah is not new (they met for a second time a few days before the British evacuated Palestine) but the extent of their collaboration—and Britain's part in it—has never been so persuasively documented. Israelis still blame Ernest Bevin, Britain's foreign secretary, for pushing the Arab Legion into Palestine because he wanted to strangle Israel.

Bevin, to be sure, was no friend of the Zionists. But Mr Shlaim shows that by February 1948, when Bevin was told of Abdullah's plans to take over the Arab parts of Palestine, he had come to regard the emergence of the Jewish state as inevitable. The British gave Abdullah a green light, while warning him away from the areas the UN had awarded to the Jews. In other words, it was the Palestinian Arab state in Palestine, not the Jewish one, that Bevin helped to thwart.

King Abdullah emerged from the 1948 war having achieved his aim of adding the central part of Palestine to his kingdom. It did him little good. In 1951 he was assassinated in Jerusalem. Israel pushed his grandson, King Hussein, back across the Jordan in the six-day war of 1967. The special relationship persists: King Hussein occasionally meets Israeli leaders in secret. But the Israelis, strong now, are no longer so eager to secure their eastern flank by political means. King Hussein has not inherited his grandfa-

BOOKS AND ARTS

ther's appetite for the indigestible West Bank. Only the Palestinians remain trapped where they were 40 years ago: stateless, yet still unwilling to buy their own statehood by recognising that of the Jews.

White House memoirs

Bile and nectar

FOR THE RECORD. By Donald Regan. *Harcourt Brace Jovanovich*; 397 pages; \$21.95. To be published in Britain in June by *Century Hutchinson*; £16.95

REVOLUTION. By Martin Anderson. *Harcourt Brace Jovanovich*; 486 pages; \$19.95

BY NOW just about everybody knows the astounding secret at the heart of Mr Donald Regan's book: the revelation that President Ronald Reagan's calendar is determined by astrological prediction. So, should anybody bother to get hold of the book and read the rest of it? Simple answer: yes. The former White House chief-of-staff's memoirs drip with self-pity and with malice. Yet they also provide an incomparable key-hole look at Mr Reagan's extraordinary presidency.

Mr Reagan's laid-back ways are public knowledge, in a general sort of way. People are aware that he likes his time off, that he cannot be troubled with detail and that he believes in delegating responsibility to his staff. All that is probably to the good; but Mr Regan reveals, far more vividly than anybody has before, what the president's amiable and trusting vagueness actually means



Now what?

to somebody working closely with him, trying to carry out his instructions.

Soon after his election in November 1980 Mr Reagan telephoned Mr Regan, then chairman of Merrill Lynch, to ask him to be his treasury secretary. "See you in Washington," said the president-to-be, ending the telephone conversation—and any discussion of the new job. Neither then, nor in the four years that followed, did the president enlighten Mr Regan with a one-to-one chat on economic or monetary policy. It gradually dawned on the baffled freshman secretary that his brief began and ended with the declaration of principles contained in Mr Reagan's election platform: if he

wanted, as indeed he did, to "let Reagan be Reagan", it was up to him to translate these principles into action.

Four years later, as the president's chief of staff, Mr Regan drew up a policy paper: a plan for an active and constructive second term. He expected the president to read this report, decide on priorities and call for more detailed suggestions. But Mr Reagan's only comment was a nod of approval: "It's good, it's really good, Don." And that was that. Mr Regan was learning, for the second time, that the president expected his lieutenants to act on his intentions, rather than on his spoken instructions. This implies a degree of trust that can lead to whopping misunderstandings.

The president's men are appalled at the composite portrait of the presidency that emerges from Mr Regan's sharp vignettes. The president is proud of his past as a professional actor. Mr Regan makes it all sound rather foolish: a president, anxious to please and not cause trouble, who parrots his managers' lines. Mr Regan's motives are suspect, his account riddled with half-truths, but there is enough that is recognisable in the portrait to make it deeply damaging.

Mr Regan scatters gobbets of arbitrary homage, praising Mr Reagan for such presidential qualities as sound judgment and good instincts. But he is so cross with his ex-boss (and, especially, the boss's wife) that he cannot bring himself to express respect for the president as a man: his words of praise turn sour when he reflects on Mr Reagan not having had the "manliness" to tell him, to his face, that it was time for him to go (in fact it was long past time). His sense of grievance detracts from the value of an illuminat-

Lawyerised

BRITISH justice must not only be done, it must be seen to be believed. There is much that is wrong with the English legal system, but nothing more so than the attitudes of its practitioners: the unjustified pretensions of the legal profession; its incompetence in the role in which it has for centuries claimed a supremacy of abilities; its unwillingness or its ignorance of the means to adapt itself to the demands of modern life in general and the claims of the citizens of the welfare state in particular.

So wrote in 1967 an eminent member of the profession, Morris Finer, then a QC but later a high court judge.

What has happened in the meantime? Nothing much; and according to Michael Zander in his book *A MATTER OF JUSTICE**, nothing that has happened (or has been proposed) will fundamentally change the system. If laws are made simpler, they will not necessarily be simple;

easier access to lawyers does not mean easier and cheaper access to justice; if the methods for selecting judges were altered, the same overwhelmingly male, middle-class and ancient would be appointed; if the two branches of the profession (barristers and solicitors) are allowed to merge, most will maintain the status quo; if police powers are increased (or decreased), it will make not a jot of difference to the crime rate nor to the overcrowding of prisons.

Mr Zander, professor of law at the London School of Economics, is a legal outsider. Perhaps all the better for that. He has produced one of the few good analytical studies of the English legal system—concise, coherent, cogent and witty, technical too but fascinating for the layman. Three suggestions for reform are offered: a bill of rights, which really means the European convention (itself a common-market bill of rights) being available in the British courts; a Ministry of Justice, which would eliminate the chaos (and much of the cost) of administering justice,

which is presently divided between the Lord Chancellor's office, the Home Office, the Attorney General's office and umpteen other government departments and executive release to reduce the prison population. However, given the absence of political will, all three are likely to be confined to solitary.

Mr Zander asks: "Is the legal system heading anywhere?" Complaints about the system have been around since legal memory, which officially begins with the reign of Richard I almost eight centuries ago. As with most institutions, legal insiders are loth to change the way things are done; when change is forced upon them they use all their ingenuity to carry on as before. "The history of the legal system", sighs Mr Zander, "is littered with improvements that made little or no difference because those concerned managed to sabotage reform." His one hope is that, today, there are fewer saboteurs around.

I.B.Tauris; 323 pages; £16.50

ing, vigorous book.

To turn from Mr Reagan to Martin Anderson is to exchange vinegar for honey. Mr Anderson was Mr Reagan's chief domestic and economic-policy adviser from 1980 to 1982; he never liked government work, but his admiration for his boss is unstinting. The president, he says, established his priorities himself (there were two, a strong defence and a strong economy), and gave the conservative movement "focus and leadership". He admits that the president made no demands and gave almost no instructions, but he considered this shrewd management; not until the Iran-contra affair (the fault, he claims, of an embittered Casey and a Colonel North corrupted by money) was Mr Anderson disabused. Mr Reagan, he still maintains, was masterly at juggling priorities. He also worked long hours on his speeches; his famous file cards, the supposed symbol of his small grasp of ideas, were in fact the reduction of whole pages of laborious thought. If his closest advisers had their doubts about his non-committal style, they kept it secret. Mr Anderson implies, with pity, that perhaps they should do so still.

Ludwig van Beethoven

A sofa, and other tales

REMEMBERING BEETHOVEN. The original biography by Franz Wegeler and Ferdinand Ries. *Andre Deutsch*; 200 pages; £11.95. Published in the United States as *BEETHOVEN REMEMBERED*; Great Ocean Publishers, Arlington, Virginia; \$16.95

"I SHALL lend you the book; one cannot stop reading it," Robert Schumann told a friend soon after the German final of this Beethoven memoir was published in 1838. He was right. Franz Wegeler was a lifelong friend of Beethoven and Ferdinand Ries, a fine pianist, was one of Beethoven's two acknowledged pupils. They might have produced a book full of praise for the master and thus, indirectly, for themselves. Instead they give us Beethoven "warts and all" through notes and reminiscences. How odd that the book has had to wait 150 years for its first English translation.

Certain tales have trickled out in English-language publications before. Here is Beethoven hiding in a cellar with a pillow over his head while the French bombard Vienna; composing amid domestic chaos and repeatedly knocking his inkwell into the piano; hurling food at a waiter who brings the wrong dish; heaping abuse on a wretched orchestra. The authors, however, were party to these scenes. Ries tells, for instance, how he had to play the piano while the master

figdged on the sofa with a lovely lady, later pursued by composer and pupil through the moonlit streets of Baden.

Fortunately the authors also have plenty to say about Beethoven as composer and pianist: how he left most of his commissioned work to the last moment, was at his most brilliant as a keyboard improviser "when in a good mood or irritated", and so on. The more information offered here, however, the deeper the mystery of composition becomes. Beethoven suddenly decided to add just two notes at the start of the adagio of the "Hammerklavier" sonata half a year after the work had been completed and was ready for publication. Ries confesses that at first he thought Beethoven had gone daft, then realised that the tiny change trans-

formed a good into a great movement. Or again, how could Beethoven compose the joyous rondo to the C major piano concerto when, as Wegeler reports, he was suffering badly from colic, gobbling medicine and under such time pressure that he thrust each sheet of completed manuscript out to four copyists seated in his hall?

Most of all, how did Beethoven summon the will to continue to compose at all when struck by deafness—that "devil in my ears", as he put it, which "has poisoned life forever"? Or could works like the last string quartets come only from a deeply lonely man locked away for good in an inner world of limitless invention? Such questions, though not new, are posed with rare force in this little book.

The flowers that bloom in the spring, tra la

Gilbert and Sullivan, Take 2

AT THE end of April the D'Oyly Carte Opera Company, premier purveyors for over a century of the works of W.S. Gilbert and Arthur Sullivan, came back to life. Aficionados have welcomed it with both joy and apprehension. Since the troupe's execution in 1982, and the subsequent death of Dame Bridget D'Oyly Carte, devotees have had to suffer through all manner of untraditional performances.

In Britain "The Raters' Iolanthe" and "The Metropolitan Mikado" coolly modernised the libretti and remodelled characters to resemble Margaret Thatcher and Ken Livingstone, the left-wing *Führer* of the Greater London Council; the English National Opera offered a de-orientalised 1920s "Mikado" with spats and tennis rackets. "The Mikado" suffered, too, in Zurich, where a female Mikado appeared in gold paint, and in Chicago, where it was reset in corporate Japan. An Australian film version of "The Pirates of Penzance" replaced most of the score with new rock songs; a hodgepodge in Vienna mixed up characters from several works.

Lack of innovation is precisely what critics disliked about the old D'Oyly Carte, which to some degree followed Gilbert's prompt-books in recreating gestures and inflections set down in the 1880s. But it was the burden of touring eight or nine shows at a time in an age of soaring costs and no government subsidies which ultimately killed the company.

Also partly responsible was the Arts Council of Great Britain. A notorious Council report issued during the final years of the company accused it of being like a doddering actress past her prime, with tired old productions and spirit, and then dared to compare its Gilbert and Sullivan to the glossier, heavily subsidised versions being



Three little co-eds

mounted by the English National Opera. Never having received any Arts Council assistance before, the D'Oyly Carte was in effect prevented by the report from any government grants in the future.

The company's death was greatly mourned by traditionalists. Members of the "inner brotherhood", including millions of amateur-operatic-society performers, swore by the regulation fan-flicks and chorus semi-circles for over a century, and copied singing and diction patterns from the many "definitive" records issued by the company. But it is questionable whether the new D'Oyly Carte will attempt to recreate much of this; it promises to be a different kettle of fish.

The new company, while grateful for the financial support of Dame Bridget's will (and the corporate assistance of British Midland Airways), seems determined to erase the traditional musical errors that crop up in performance. The new musical director, Mr Bramwell Tovey, whose background is in

classical music, held hundreds of vocal and orchestral auditions earlier this year to help ensure no repeat of previous "misguided musical directions". His aim is to "take Gilbert and Sullivan into the twenty-first century" with a "definitive musical stance" based on Sullivan's original manuscripts.

Few former D'Oyly Carters appear in the roster. But there are many West End talents and rival opera-company names, including some from the New Sadler's Wells Opera, which has been producing its own, re-thought Gilbert and Sullivan with some success. Mr Christopher Renshaw, who staged three of these, is directing the D'Oyly Carte "Yeomen of the Guard". He plans several deviations from tradition, including a first act that takes place almost entirely indoors and the incorporation of several numbers originally cut by the authors. "Iolanthe", the other operetta to be revived in the first season, will be staged by Mr Peter Walker, whose prior experience includes a production of the popular New York revival of "The Pirates of Penzance".

After a spring tour, it is hoped the company will be able to reclaim London's Savoy Theatre by the autumn, in order properly to celebrate the "Yeomen" centenary in its birthplace. An American tour is also being discussed. And when asked whether the company would consider someday doing non-Gilbert and Sullivan works, the answer (oh, horror!) was not negative.

Classical sculpture

False notes

THE LAQUID girl below may not be all she seems. A century ago she turned up near the Gardens of Sallust, in Rome, without proper proof of identity. The land on which she was found was the property of the Ludovisi family, who had a collection of



Too wanton to be ancient?

Le Pen et La Pucelle

TOULOUSE

JOAN OF ARC—conqueror of the English and Burgundians, convicted witch and saint of the Church—has been popping up more than usual in the latest French election campaign. The second round of the presidential elections, on May 8th, coincided with her feast day; leading politicians and columnists competed for her favours. Mr Jean-Marie Le Pen, the leader of the far-right National Front, calls her his "little sister" and says she helped him win his 4.4m votes in the first round. His followers' hymn to Joan runs, in part: "Joan, if you could see your beloved, drugged, AIDS-ridden, prostituted France, you would sound the alarm and take up arms again."

Worshippers of Joan—with the exception of some communists, who see her as a freedom-fighter—traditionally belong to the Catholic and nationalist right. "Jeanne, me voilà! (Here I am!)" Charles de Gaulle once exclaimed before a statue of the Maid in Orleans, where she was born. But nationalism has spread leftwards this spring. "Give us back our

Joan!" an opponent of Mr Le Pen cried in *Le Monde*, accusing him of abducting France's national heroine and "eternal lover". Mr Jean-Pierre Chevènement, the new Socialist defence minister, wants to "revive France's sense of destiny", and sees in Joan a symbol of republican patriotism alongside the Marseillaise and the tricolor.

Throughout this century "official" historians, as well as politicians, have tended to inflate figures such as Joan and Charlemagne to heroic proportions. The trend is especially strong in books published since the second world war, as if to counter the unpalatable truth that France had to be liberated from Nazi occupation by Britain and America. Since 1945 textbooks have taught that Joan "made the French understand that they should unite to defend their homeland" and "would not let foreigners rule her country." One word of comfort, however, for France's allies: the new prime minister, Mr Michel Rocard, has recently pointed out that three-quarters of Joan's troops were foreigners.

ancient sculpture built up over many years; John Evelyn and Henry James both admired it. At the time of her discovery the family was selling off much of its land to Generale Immobiliare, the same company that later built the Watergate in Washington. Rome was also full of talent-scouts for both the new Fine Arts Museum in Boston and the new Carlsberg Museum outside Copenhagen, both of which were about to be led a dance by the cash-and-carry antiquarians of the Via Margutta.

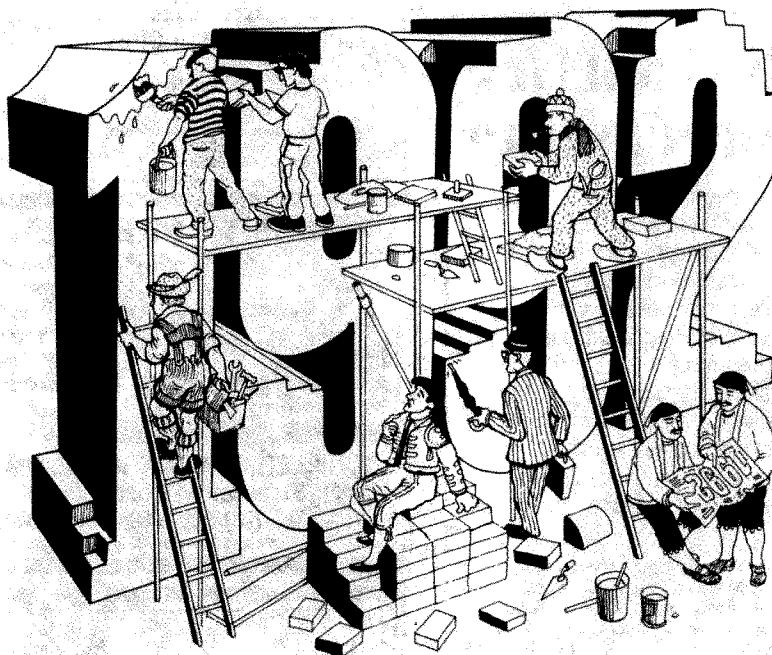
The side-panel on which the girl appears is one of three marble slabs known collectively as "the Ludovisi throne". It was dated to the fifth century BC and praised as one of the best Greek pieces ever discovered, although nobody knew quite what it was: possibly a sanctuary railing round a statue of Aphrodite, possibly a wind-break. In 1892 Edward Warren, the Europe-based agent for the Boston museum, offered 150,000 lire for it. He was told that it could not be exported, but as luck would have it another "throne", a twin, had turned up in the same area. Warren paid 165,000 lire for that, and it went to Boston, where it sits still.

According to a study by Mrs Margherita Guarducci, just published in the May bulletin of the Ministry of Culture, the Boston throne was almost certainly the reworking of an old sarcophagus. A journeyman sculptor probably did the work, under instruction by German experts, sometime in the autumn of 1894. As early as 1949 a restorer

looked at the piece and reported that the brown tracings in the marble were made, not by ancient insects, but by Mayer's glue, much used in Rome in the last century. The Boston museum's own examination in 1960 pronounced the marble "ancient Greek" (that is not in dispute), and admitted that the carving was Greek-Roman. Not nineteenth-century Roman, however.

So what of the Ludovisi twin? A fortnight before Mrs Guarducci's article, Rome's most famous maverick art historian, Federico Zeri, announced on a television talk-show that he had always known Ludovisi throne to be a fake. The figure of Aphrodite on the main panel is, he says, much too voluptuous, "and one could drive a train between those extraordinarily pronounced breasts." As for the flute-girl, her wantonly crossed legs would not have been acceptable in classical times.

Mr Zeri says he does not need much more proof. And although few others accept his judgment, it is hard to question intuition; most art-authentication comes to rest, in the end, on that. So Mr Zeri has caused a nervous thrill in Rome. Who knows how many other well-known and much-authenticated objects will turn out to be forgeries? On May 4th *Corriere della Sera* ran a large comic strip featuring "the art critic Federico Uno" under the appalling headline "The Colosseum a Fake: Built in 1500 to Encourage Tourism and Pilgrimages".



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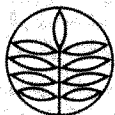
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Applications (three copies), which should include a full curriculum vitae, including the exact date of birth, together with the names and addresses of three persons to whom reference may be made, should be lodged with the Establishment Officer, University of East Anglia, Norwich NR4 7TJ (telephone 0603 56161, ext 2734) from whom further particulars may be obtained, not later than 7 June 1988. No forms of application are issued.

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Applications (quote Ref: R21/88) with curriculum vitae and the names and addresses of three referees should be sent to Professor I. H. McNicoll, Fraser of Allander Institute, University of Strathclyde, Curran Building, 100 Cathedral Street, Glasgow G4 0LN, by 13 June 1988. Tel: 041 552 4400, extensions 3960/3962, for further information.

University of Newcastle upon Tyne

Department of Economics, Accounting and Management

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Salary will be at an appropriate point on either the Grade A scale: £9,260-£14,500 per annum, or Grade B scale: £15,105-£19,310 per annum according to qualifications and experience.

Further particulars may be obtained from the Senior Assistant Registrar (Establishments), The University, 6 Kensington Terrace, Newcastle upon Tyne NE1 7RU, with whom applications (three copies), together with the names and addresses of three referees should be lodged not later than 10 June 1988.

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Enquiries of an academic nature may be directed to Ray Ensley (tel: 010-613 471281).

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Applications (quoting reference number 88/58) should include a full curriculum vitae and the names and addresses of three academic referees, and reach the Personnel Branch, Deakin University, Geelong, Victoria 3217, Australia, no later than 30 June 1988. Applicants resident in North America and Europe should send a copy of their application to the Association of Commonwealth Universities (Appts), 36 Gordon Square, London WC1H 0PF, from whom further details are Available.

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Reactions should be addressed to the Personnel and Organization Department of

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*Department of Computing and
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Further information may be obtained from the Association of Commonwealth Universities (Appts), 36 Gordon Square, London WC1H 0PF, or from the Head of the Department of Marketing, or Mrs V. B. Bretherton, Personnel Section, Massey University, Palmerston North, New Zealand, with whom applications close on 20 June 1988.

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ECONOMIC AND FINANCIAL INDICATORS

1

OUTPUT, DEMAND AND JOBS America's industrial production grew by 0.7% in April, for a 12-month rise of 6.4%. In the year to March Sweden's industrial output fell 1.9%. Britons are still spending furiously, though less so than before: retail sales rose 4.5% in the year to April. Six countries reported unemployment figures for April: Australia's rate was 7.9% (down from 8.3% a year ago); Belgium's 10.8% (from 11.7%); Holland's 14.0% (almost unchanged); Italy's 15.6% (up from 13.7%); Spain's 20.0% (almost unchanged); Sweden's 1.6% (down from 1.9%).

% change at annual rate

	industrial production		GNP/GDP		retail sales [volume]		unemployment % rate	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year	latest	year ago
Australia	+ 9.2**	+ 6.2** Dec	+ 6.1	+ 4.6 Q4	- 0.5	+ 1.9 Q4	7.9 Apr	8.3
Belgium	+ 1.7	+ 0.7 Dec	na	na	+ 3.5	- 0.6 Dec ‡	10.8 Apr*	11.7
Canada	+ 3.4	+ 5.7 Feb	+ 6.3	+ 5.7 Q4	+ 1.9	+ 5.1 Feb	7.7 Apr	9.3
France	+ 2.6	+ 2.9 Feb	+ 1.6	+ 2.5 Q4	+ 1.5	- 1.1 Jan	10.3 Mar	10.8
W. Germany	+ 2.6	+ 2.3 Mar	+ 2.9	+ 2.3 Q4	+ 5.2	+ 7.0 Mar	8.9 Apr	8.9
Holland	- 7.3	- 2.8 Feb	+ 9.6	+ 1.5 Q3	+ 7.9	+ 4.9 Dec ‡	14.0 Apr	14.1
Italy	+11.5	+ 7.8 Jan	+ 1.8	+ 2.4 Q3	+ 8.1	+ 2.8 Sep ‡	15.6 Apr*	13.7
Japan	+14.4	+11.3 Mar	+ 7.0	+ 5.3 Q4	+ 6.4	+ 8.4 Jan	2.6 Mar	2.9
Spain	- 3.4	+ 4.0 Feb	na	na	+15.5	+14.0 Q1 ‡	20.0 Apr	20.2
Sweden	-11.9	- 1.9 Mar	+ 3.7	+ 2.4 Q4	- 9.1	- 0.1 Jan	1.6 Apr*	1.9
Switzerland	+24.1	+ 5.6 Q4	+ 2.1	+ 2.7 Q4	+ 3.9	- 0.6 Dec ‡	0.8 Mar*	0.9
UK	- 0.8	+ 3.3 Feb	+ 2.7	+ 4.3 Q4	+ 4.7	+ 4.5 Apr	9.0 Mar	10.9
USA	+ 3.2	+ 6.4 Apr	+ 2.3	+ 3.5 Q1	+ 6.6	+ 1.2 Mar	5.4 Apr	6.2

† Value index deflated by CPI. ** New series.

PRICES AND WAGES Japan's wholesale prices fell 0.7% in the year to April. Sweden's wholesale prices rose 4.8% in the year to March; its consumer prices climbed 6.1% in the 12 months to April. In the year to March Spain's wholesale prices increased by 2.8%; its consumer prices rose by 4.6% in the year to April. Holland's 12-month rate of consumer-price inflation edged up to 0.7% in April. West German wages climbed by 3.0% in the year to March—a real pay rise of 2.0%.

% change at annual rate

	consumer prices*		wholesale prices*		wages/earnings†	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year
Australia	+ 7.2	+ 7.1 Nov	+ 7.4	+ 6.7 Dec	+ 9.8	+ 5.8 Nov*
Belgium	+ 1.7	+ 1.0 Apr	- 1.2	- 0.8 Jan	+15.4	+ 2.8 Q4*
Canada	+ 3.3	+ 4.1 Mar	+ 3.0	+ 4.6 Mar	+ 6.7	+ 4.1 Feb*
France	+ 2.0	+ 2.5 Mar	+ 4.3	+ 3.1 Q4	+ 3.3	+ 3.5 Jan*
W. Germany	+ 2.4	+ 1.1 Apr	+ 1.3	+ 0.6 Mar	+ 1.6	+ 3.0 Mar
Holland	- 0.5	+ 0.7 Apr	- 1.0	- 0.1 Feb	+ 0.7	+ 0.5 Mar
Italy	+ 5.0	+ 5.0 Apr	+ 4.5	+ 4.3 Mar	+ 8.5	+ 7.1 Dec*
Japan	- 2.1	+ 0.7 Mar	- 3.0	- 0.7 Apr	+ 0.6	+ 2.2 Mar
Spain	+ 5.8	+ 4.6 Apr	+ 3.3	+ 2.8 Mar	+ 8.0	+ 9.1 Feb
Sweden	+ 6.6	+ 6.1 Apr	+ 7.0	+ 4.8 Mar	+ 9.4	+ 6.2 Jan*
Switzerland	+ 3.5	+ 1.9 Apr	+ 2.1	+ 1.5 Mar	nil	+ 2.1 Q4*
UK	+ 2.0	+ 3.5 Mar	+ 5.8	+ 4.2 Apr	+ 9.9	+ 8.5 Feb
USA	+ 2.4	+ 3.9 Mar	+ 1.4	+ 1.7 Apr	+ 2.6	+ 2.9 Apr

Hourly wage rates in manufacturing except Australia, weekly earnings; Japan, and Switzerland, monthly earnings; Belgium, Canada, Sweden and USA, hourly earnings; UK, monthly earnings for all employees.

The Economist COMMODITY PRICE INDEX

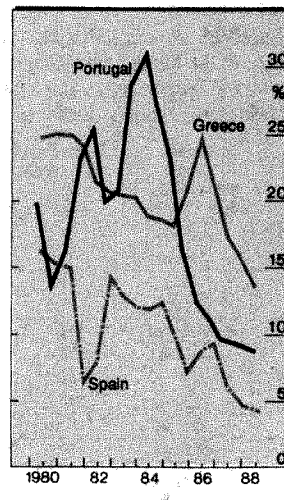
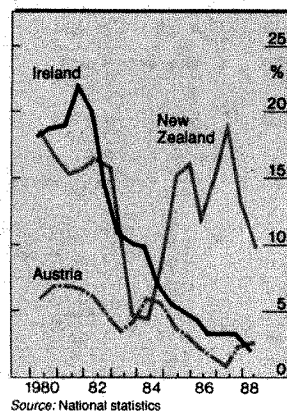
New supplies of platinum in non-communist countries are likely to fall short of demand in 1988 for the fourth year running, according to a report by Johnson Matthey. Demand reached a record 3.3m ounces in 1987, outpacing supply by 200,000 ounces. Fuelled by the strong yen, Japanese demand rose 63% to 1.7m ounces; more than half of this was for use in jewellery. Western Europe's carmakers used 200,000 ounces, 85% more than in 1986. This year demand in both Japan and Europe is likely to rise again. The market is worried that a possible American trade embargo against South Africa might curtail supply, and that Russia will export less platinum next year.

1985=100	May 10	May 17	% change on one month	% change on one year
Dollar index				
All items	149.2	158.6	+12.6	+44.5
Food	107.5	110.5	+ 5.1	+15.2
Industrials				
All	190.6	206.4	+17.1	+67.2
Nfa ‡‡	151.5	153.9	+ 1.8	+17.6
Metals	218.3	243.6	+25.5	+106.1
Sterling index				
All items	101.6	109.1	+14.5	+30.6
Food	73.2	76.0	+ 6.8	+ 4.1
Industrials				
All	129.8	142.0	+19.0	+51.0
Nfa ‡‡	103.2	105.9	+ 3.5	+ 6.3
Metals	148.7	167.6	+27.6	+86.2
SDR index				
All items	109.6	116.8	+13.3	+37.1
Food	79.0	81.4	+ 5.7	+ 9.2
Industrials				
All	140.1	152.0	+17.8	+58.5
Nfa ‡‡	111.3	113.3	+ 2.4	+11.6
Metals	160.5	179.4	+26.3	+95.5
Gold				
\$ per oz	447.00	454.25	- 6.0	- 3.4
Crude oil North Sea Brent				
\$ per barrel	16.40	16.78	- 1.3	-10.5

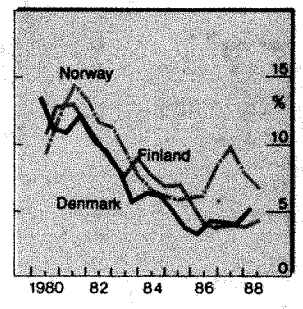
‡ provisional ‡‡ Non-food agricultural

INFLATION Last year the OECD's average rate of consumer-price inflation picked up slightly, to 3.3%. But inflation in the nine smaller OECD countries shown in the chart fell again, to 5.9%—still above the OECD average, but down from 7.4% in 1986. This year their average inflation rate looks set to fall further, despite higher commodity prices. Portugal has seen the highest inflation of the nine in the 1980s: in 1984 its consumer prices were rising by more than 30% a year. Now Portugal's inflation is below 9%, leaving Greece to pick up the wooden spoon—its consumer prices are still increasing by 13.4% a year. Ireland, which had an inflation rate of over 20% in the early 1980s, now has the lowest rate of the nine, at 1.9%. Austria now has a rate of 2.2%—up from 0.8% early last year.

Consumer prices % increase on a year earlier



% increase on previous year
 00 Total OECD
 0-9 Countries in chart
 1980 1981 1982 1983 1984 1985 1986 1987
 12.9 10.5 7.9 5.3 5.3 4.5 2.5 3.3
 13.7 13.9 12.6 10.2 9.8 8.1 7.4 5.9



Footnotes applicable to all tables. All figures seasonally adjusted except * not seas. adj. † Average of latest 3 months compared with avg. of previous 3 mos, at annual rate. na not available.

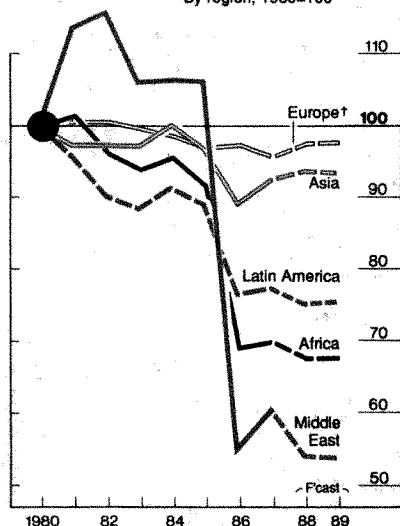
ECONOMIC AND FINANCIAL INDICATORS

2

TERMS OF TRADE The ratio of a country's export prices to its import prices—its terms of trade—measures the purchasing power of its exports in terms of the imports they will buy. If export prices fall relative to import prices (ie, the terms of trade worsen) a given quantity of exports will buy fewer imports than before. Middle-Eastern countries saw their terms of trade tumble by 48% in 1986 as the price of their biggest export, oil, crashed. In 1986 falling commodity prices and the feeble dollar hurt Latin America and Africa too, but in 1987 most developing countries' terms of trade improved as commodity prices started to recover. The IMF forecasts that Asian and European developing countries—less dependent on raw-material exports—will see their terms of trade improve again in 1988; but it expects a slight deterioration in Latin America, Africa and the Middle East.

Developing countries' terms of trade*

By region, 1980=100



*Ratio of export prices to import prices †Greece, Hungary, Poland, Portugal, Romania, Turkey, Yugoslavia Source: IMF

WORLD BOURSES Wall Street was unimpressed by the big drop in America's trade deficit, and fell 0.9%. London fell 0.2%. Tokyo climbed 1.5% to a record high. The other big bourses remain at least 20% below their highs.

Stock price indices

	May 17	1988		% Change on				
		high	low	one week	one year	record high	31/12/87 in local currency	in \$ terms
* May 16								
Australia	1438.7	1467.6	1170.7	+ 2.8	- 21.8	-37.6	+ 9.7	+16.4
Belgium	4691.7	5043.1	3608.4	- 0.5	+ 2.7	-13.4	+28.4	+18.4†
Canada	3223.2	3402.4	2977.9	- 2.1	- 14.4	-21.6	+ 2.0	+ 7.3
France	308.8	314.3	251.3	- 1.4	- 29.2	-32.9	+10.0	+ 1.9
W. Germany	1346.3	1457.5	1207.9	+ 2.7	- 23.2	-40.9	+ 3.6	- 4.3
Holland	243.4	280.3	205.7	+ 0.9	- 16.8	-27.1	+16.6	+ 8.3
Hongkong	2533.6	2684.1	2223.0	- 1.1	- 12.1	-35.9	+10.0	+ 9.3
Italy	480.4	545.1	423.9	- 3.1	- 31.2	-47.1	- 1.6	- 9.3
Japan	27820.0	27820.0	21217.0	+ 1.5	+ 15.5	nil	+29.0	+24.5
Singapore	970.7*	976.1	833.6	+ 0.4	- 19.1	-35.5	+17.9	+17.1
South Africa	1512.0	1564.0	1387.0	+ 1.7	- 22.3	-33.3	+ 4.8	+12.3†
Spain	272.0	281.1	225.5	+ 0.5	+ 22.1	-16.4	+19.7	+14.5
Sweden	2856.3	2858.1	2148.5	+ 0.7	+ 9.6	-12.6	+31.6	+28.6
Switzerland	507.0	539.5	466.6	+ 0.7	- 13.8	-30.5	+ 6.9	- 4.0
UK**	1789.2	1855.5	1694.5	- 0.2	- 19.2	-26.8	+ 4.5	+ 3.6
USA	1986.4	2110.1	1879.1	- 0.9	- 10.6	-27.8	+ 2.5	+ 2.5

**New series (FT-SE 100)

†Converted at financial rate

MONEY AND INTEREST RATES In the year to April the growth of America's narrow measure of money slowed to 3.4%; growth in its broad measure quickened to 6.0%. Britain's banks cut their prime lending rates by half a percentage point.

Money supply			Interest rates % p.a. (Tuesday, except bonds which are previous Friday)							
% rise on year ago	Narrow [M1]	Broad†	Money market		Commercial banks		Bond yields		Eurocurrency	
			Overnight	3 months	Prime lending	Deposits 3 months	Gov't long-term	Corporate	Deposits 3 months	Bonds
Australia	+19.6	+13.9 Mar	12.00	12.40	13.75	12.20	12.33	13.33	12.25	12.50
Belgium	+ 7.7	+12.7 Q3	6.00	6.10	8.50	5.80	7.74	7.95	6.16	na
Canada	+ 1.8	+ 5.6 Apr	8.75	9.00	10.25	7.50	10.34	10.54	8.94	10.07
France	+ 3.1	+ 9.2 Jan	7.38	7.88	9.45	8.00	9.18	9.82	8.06	9.13
W. Germany	+10.5	+ 6.1 Mar	3.30	3.60	5.50	3.28	6.25	5.95	3.56	4.74
Holland	+ 7.2	+ 4.8 Feb	3.63	4.19	5.75	3.50	6.13	6.64	4.13	6.19
Italy	+ 9.0	+ 9.5 Nov	10.13**	10.88**	12.63**	na	10.45**	10.74**	10.38	na
Japan	+ 9.5	+11.8 Mar	3.13	3.79	3.38	1.76	4.69	4.31	4.13	4.61
Spain	+10.3	+14.0 Dec	10.93	11.35	14.50	7.50	12.24	13.50	9.38	na
Sweden	na	+ 5.4 Feb	10.80	10.85	12.00	10.51	11.42	12.20	10.63	na
Switzerland	+18.1	+11.6 Feb	1.75	2.44	5.25	1.50	3.97**	4.29**	2.44	4.51
UK	+20.8	+20.9 Mar	6.44	7.97	8.50	7.81	9.35	10.68	7.81	9.80
USA	+ 3.4	+ 6.0 Apr	6.63	7.22	9.00	7.27	9.11	9.65	7.50	8.78

Other key rates in London 3-mth Treasury Bills 7.7%, 7-day Interbank 7.4, clearing banks' 7-day notice 2.0%. Eurodollar rates (Libor): 3 mths 7.4%, 6 mths 7.6%.

†M2 except Australia, Canada, Spain, Switzerland, USA, UK, W. Germany M3, Japan M2 plus CDs. Definitions of interest rates quoted available on request. Sources: Bank of Bilbao, Chase Manhattan, Banque de Commerce (Belgium), Nederlandse Credietbank, Credit Lyonnais, Svenska Handelsbanken, ANZ Bank, Credit Suisse First Boston, Wharton Econometrics. These rates are indicative only and cannot be construed as offers by these banks. ** Last week's rates.

TRADE, EXCHANGE RATES AND RESERVES America's visible-trade deficit was \$9.7 billion in March, much smaller than had been expected; the 12-month trade deficit fell to \$168 billion. In the same month Canada's 12-month trade surplus fell to \$7.1 billion. In February West Germany's trade surplus was \$4.9 billion; its 12-month trade surplus fell to \$64.3 billion, and its 12-month current-account surplus fell to \$44 billion. In trade-weighted terms the dollar climbed 1.0%, sterling was roughly unchanged, the D-mark fell 0.5% and the yen fell 0.6%.

	trade balance‡ \$bn		current-account balance \$bn latest 12 mths	trade-weighted‡‡ exchange rate		currency units per \$		currency units			foreign reserves†† \$bn	
	latest month	latest 12 months		latest	year ago	latest	year ago	per £	per SDR	per ecu	Mar	year ago
Australia	- 0.03 Mar	- 0.1	- 8.5 Mar	57.5	56.1	1.30	1.39	2.42	1.76	1.59	9.3	6.5
Belgium	- 0.32 Dec	- 0.1	+ 2.6 Q3	100.0	100.1	35.6	36.9	66.3	48.1	43.6	9.2	6.1
Canada	+ 0.46 Mar	+ 7.1	- 7.3 Q4	81.4	76.1	1.24	1.34	2.31	1.67	1.53	11.7	6.9
France	+ 0.32 Mar	- 4.8	- 4.5 Q4	71.0	71.8	5.77	5.95	10.8	7.80	7.07	31.2**	31.8
W. Germany	+ 4.90 Feb	+ 64.3	+ 44.5 Feb	147.7	147.4	1.70	1.78	3.17	2.30	2.08	73.0	60.4
Holland	- 0.01 Dec	+ 1.6	+ 2.5 Q3	137.0	135.6	1.91	2.00	3.56	2.58	2.34	15.4	12.2
Italy	- 0.86 Dec	- 8.7	+ 5.9 Q1§	46.2	47.3	1265	1290	2357	1710	1550	29.9	25.1
Japan	+ 8.40 Mar	+ 94.2	+ 83.7 Mar	244.7	225.5	126	140	234	170	155	84.3	58.3
Spain	- 1.60 Mar	- 16.1	+ 0.6 Mar	51.8	48.6	113	125	210	152	138	31.8**	15.5
Sweden	+ 0.48 Mar	+ 3.7	- 1.6 Feb	69.0	68.6	5.92	6.23	11.0	8.01	7.28	8.6	7.9
Switzerland	- 0.19 Jan	- 5.1	+ 7.0 Q4	173.5	175.6	1.42	1.46	2.65	1.92	1.74	24.2	20.8
UK	- 1.57 Mar	- 20.5	- 7.4 Mar	78.4	73.8	0.54	0.59	-	0.73	0.65	41.4	21.5
USA	- 9.75 Mar*	-168.0	-160.7 Q4	93.5	100.0	-	-	1.86	1.38	1.24	32.1	38.7

‡Australia, France, Canada, Japan, and UK imports fob, exports fob. All others cif/fob. ‡‡ Bank of England index 1975 = 100. †† Excluding gold. * Not seasonally adjusted. ** February \$1987.

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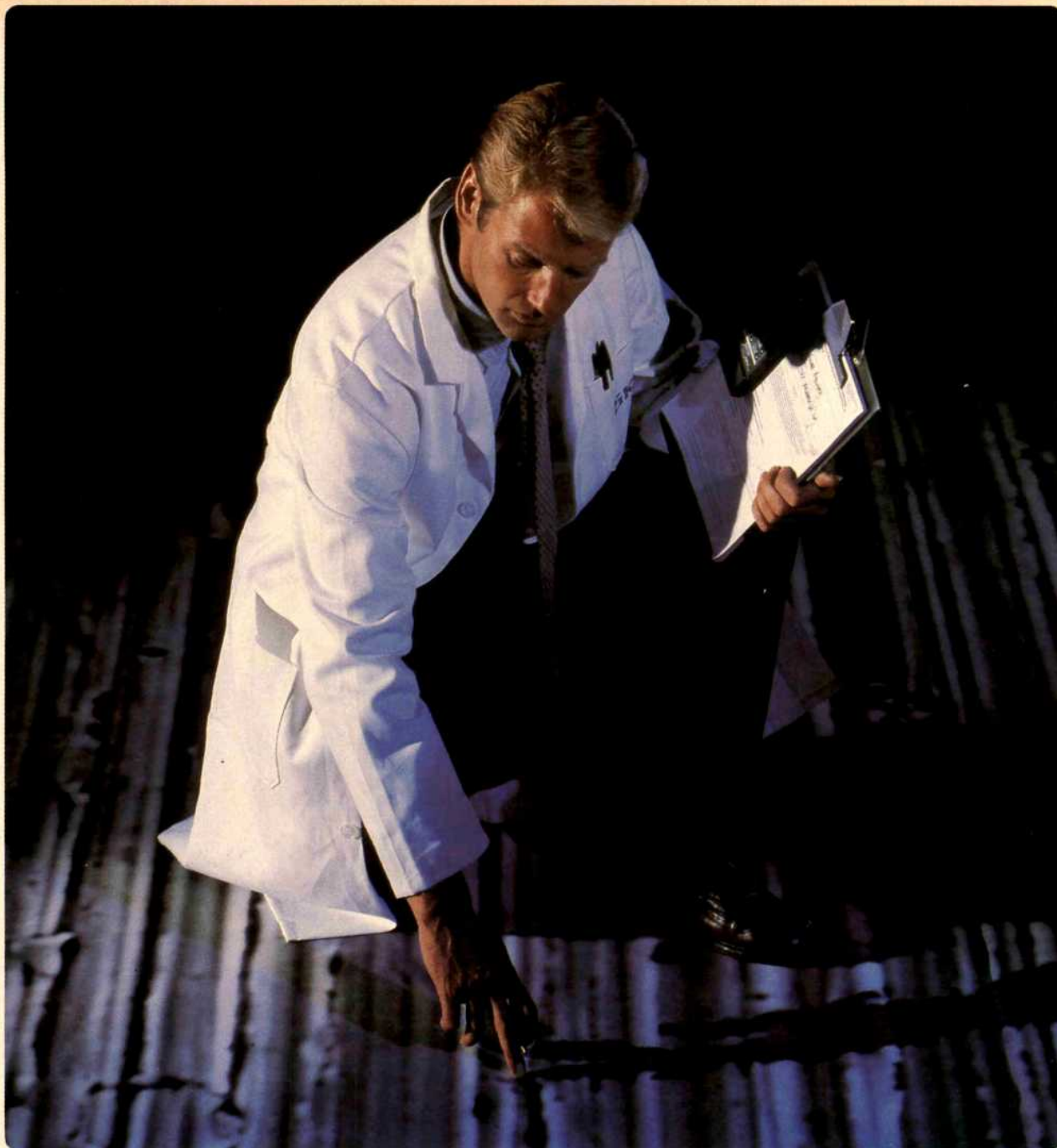
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executives tend to feel more relaxed and more focused at Hyatt.

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BENIGHTED SINGAPORE

POLLS FOR DUKAKIS

IS WALL STREET BUST?

ANOTHER NEW WORLD

A survey of Portugal

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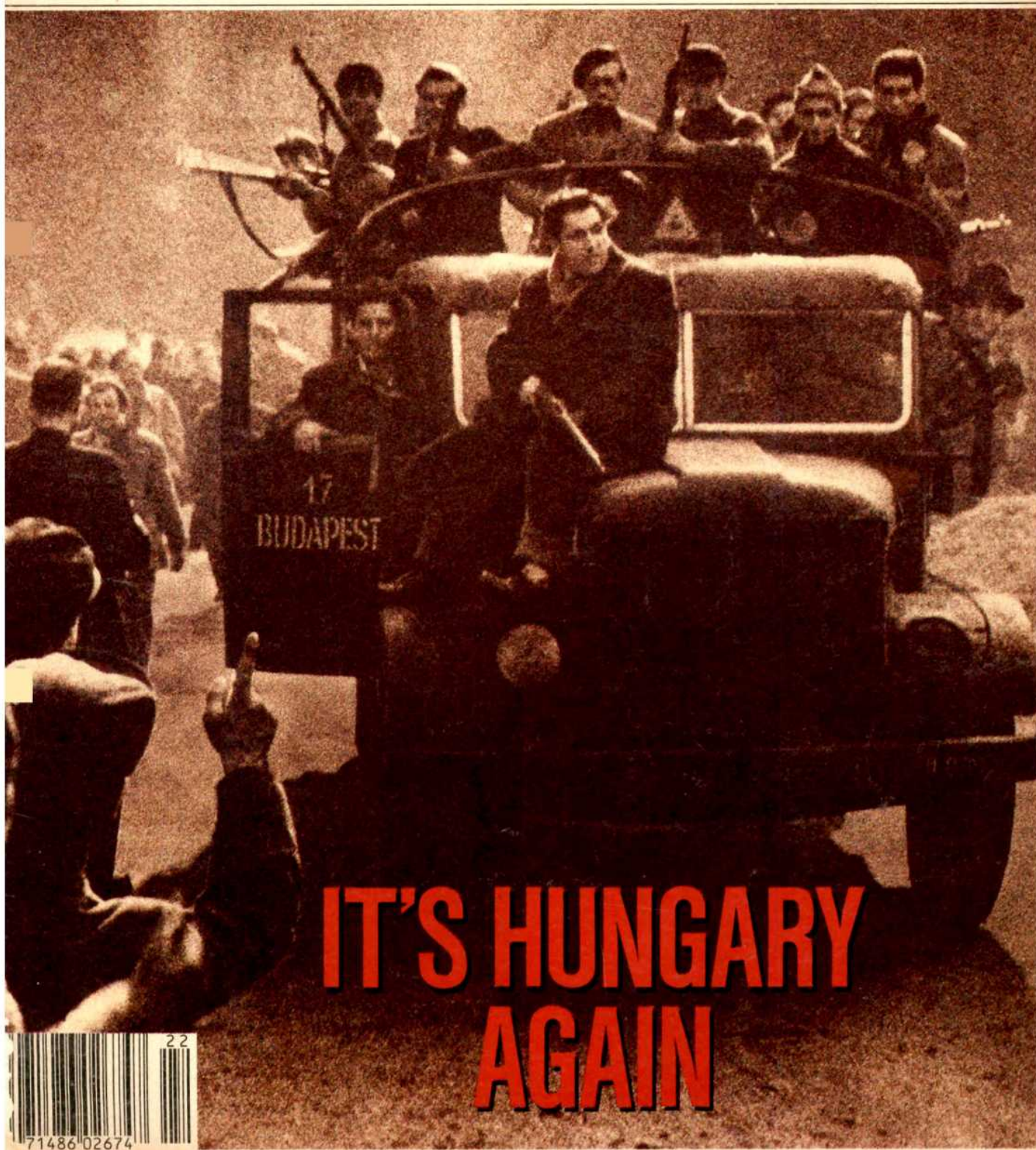
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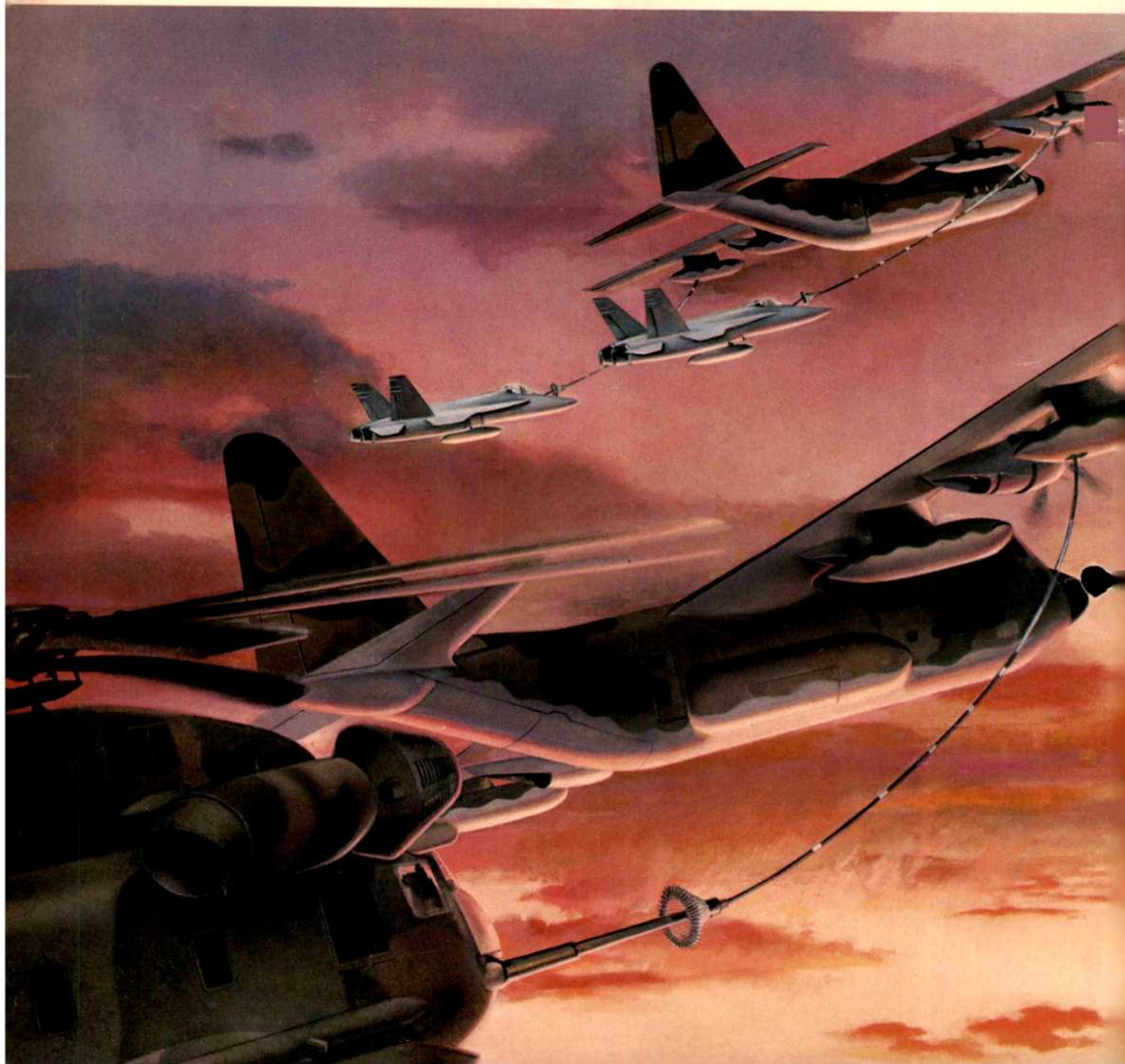
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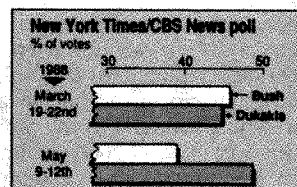
It's Hungary again

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Another new world

Portugal sets out to discover Europe. A survey after page 56.

LETTERS

Looking to Moscow

SIR—Your comparison of President Botha's attempts at reform with those attempted by Mr Gorbachev (April 30th), is totally unrealistic in the context of South Africa. The reforms attempted so far are not seen by most South African white voters as being too few to see off the risk of ruin. A growing number think they have already gone too far and too fast. To do anything of what you are suggesting would almost certainly mean that Mr Botha would split his party and be out of a job.

It would be different if he had anything to show for what he has done so far. The conservative white South African thinks that there have been radical concessions, which have resulted in increased pressure and the risk of greater sanctions. If the West wants a quicker pace of reform, it must make it possible for Mr Botha to retain the support of the white voters.

Johannesburg H. DE G. LAURIE

Off the bottle

SIR—Contrary to what you say in your article about government advertising (April 30th), General Accident did not need persuading to invest in the promotion of road casualty reduction. It was their idea. We co-operate with their initiatives. We support their work.

Self-interest without selfishness should lead others in the

field. There are major private benefits in addition to more clout when companies help to cut the causes and consequences of crashes and collisions.

Incidentally, research by the Central Office of Information shows that our advertising has been effective in shifting attitudes against drinking and driving.

PETER BOTTOMLEY
Department of
Transport

London

Japanese women

SIR—The status of Japanese women reflects the characteristics of Japan's hierarchical society (May 14th). Its prosperity is based on the system of division of labour between men and women (men for work, women for household). It is so successful that even rational young men fear that the breakdown of this stable system might herald the end of Japan's success.

Strangely this feeling is also shared by most Japanese women. They are in a well-protected and, in a sense, strong position at home. This helps explain why there are so few ambitious Japanese women.

At St John's College, Oxford, which has been open to women since 1978, more than a third of the students are female. Although Tokyo University has been open to females since 1947, only about 5% of the students are women. It is apparent from this that Japanese women them-

selves are partly responsible for the present situation.

This does not leave men spotless. Their prejudices are strengthened by the alleged success of the sexual division of labour. Many men also seriously believe that women are actually inferior.



I believe a society can be built where equal opportunities for men and women can be fitted into the Japanese tradition. As you point out, such an accommodation will anyway be inevitable in order to maintain the present economic prosperity. It could enlighten leading Japanese professional men, many of whom, I hope, are readers of *The Economist*.

YUKO KAWAMOTO
St John's College
Oxford

Habsburg intervention

SIR—You wrote about my parliamentary initiative concerning Andorra (May 7th). I wish to make it clear that, as a Euro-parliamentarian, I work for all Europeans, not just for my Bavarian constituency.

All I did was to ask the European Commission for a report on Andorra in view of the current negotiations. I did so because the parliament has been elected to control the commission and hence must be informed. I was certainly not prompted by the Spanish government. My colleagues and I acted because news had reached us about certain plans of less-than-desirable politico-financial groups endeavouring to use Andorra for their own aims.

You say that I am "sometimes regarded as a bit of an anachro-

nism". Pray, let me know what this means—or is it merely one of those verbal scarecrows with which many writers hide their ignorance? Incidentally, I do not feel insulted, since I always prefer deliberate anachronism to spineless opportunism.

Pöcking,
West
Germany OTTO VON HABSBURG

SIR—Why shouldn't Mr von Habsburg be concerned with the rights of Spanish workers in Andorra? Had the first Duke of Marlborough had a less charming sister and a more charming wife, Mr von Habsburg might have been king of Spain today. Unfortunately for Mr von Habsburg's career, the Duke of Berwick, Arabella Churchill's by King James II of England, ularly defeated Habsburg forces in Spain during the war of the Spanish succession. Meanwhile, the pro-war, pro-Habsburg party in Britain lost power when Sarah Churchill lost the favour of Queen Anne, leading Britain to make peace and ending all prospect of recreating the empire of Charles V.

Auburn,
California H.A. FLEMING JR

Richard Nixon

SIR—The former president is not a "dog" (April 16th). He lives, I believe, in a house, not a "basket". Please mind your manners in the future when referring to a former chief executive of the United States.

New York OWEN MCGIV

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The Programme is currently reviewing its range of activities and opportunities will exist for innovative contributions in this regard from the persons appointed.

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Further details may be obtained from the Chief Personnel Officer, Commonwealth Secretariat, Marlborough House, Pall Mall, London SW1Y 5HX. Telephone 01-839 3411, ext 8134 or 8152, to whom all correspondence should be addressed, specifying the post applied for. The closing date is 15 July 1988.

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General

The International Livestock Centre for Africa (ILCA), with headquarters in Addis Ababa, Ethiopia, is one of the 13 international agricultural research organisations supported by the Consultative Group on International Agricultural Research (CGIAR).

ILCA's major activities are research, training and information, and its goal is to achieve measurable and sustainable increases in livestock output in sub-Saharan Africa.

Position

ILCA seeks to employ an English Editor/Writer in its Information Section.

The Information Section at ILCA headquarters in Addis Ababa is responsible for producing a wide range of scientific publications in English and French which are distributed to scientists, policy makers and educators in sub-Saharan Africa and to scientists and donors outside Africa. ILCA's publications include material based on research by both ILCA scientists and national programme scientists in sub-Saharan Africa. The Centre's regular publications series consists of the newsletter, bulletin, research report, annual report and conference proceedings.

The English Editor/Writer is required to edit manuscripts for publication in any one of the Centre's regular series; write articles on various aspects of ILCA's work for the Newsletter and for outside publications; provide editorial and linguistic advice to scientific staff; and train and supervise editorial staff.

Qualification

Applicants should have a Degree in Agriculture or related field and formal or on-the-job training in scientific communications.

Applicants should also have a minimum of five years' experience in English scientific editing to the highest international standards, knowledge of international agricultural research (preferably livestock research) and the ability to express scientific concepts in clear terms. Knowledge of statistics and word-processing are required; competency in French is desirable. A demonstrated ability to interact effectively with people of different nationalities and disciplines will be an advantage.

This appointment may be initially up to a three-year period. Salary and related benefits are paid in US\$ and will be in line with comparable international organisations. Initial salary will be determined by qualification and experience.

Applicants should send current curriculum vitae, recent salary history, names and addresses of three professional referees and photocopies of supporting documents (not returnable) before June 30, 1988, in confidence to:

The Personnel Manager
ILCA
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AND

DIRECTOR, FIELD OPERATIONS (REF 202E)

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It's Hungary again

ONLY a Hungarian, it is said, can enter a revolving door behind you and come out in front. Hungary's new boss has just shown how it is done. Mr Karoly Grosz has swivelled past Mr Janos Kadar, who had ruled Hungary for 32 years, and in the same deft movement replaced over half of the party's Politburo and over a third of its Central Committee. This is a mind-boggling manoeuvre

in a part of the world where nobody is ever sure how—or whether—one set of leaders can be swapped for another. Just as reform in Hungary was beginning to look as tired as the 76-year-old Mr Kadar himself, it has suddenly swung back to life. Hungary now has a chance to explore the limits of freedom in the Gorbachev empire.

What most Hungarians (like most Poles, Czechoslovaks, Lithuanians or Estonians) really want is not to be communist at all. They would rather be democratic and capitalist, and probably neutral, like the Austrians next door. But in 1956 Soviet tanks taught them there was to be no defection from communism. For years Hungarians settled for the Kadar compromise—roughly, *glasnost* and “market socialism” in exchange for acceptance of one-party control and loyalty to Russia—as the best available anywhere in Eastern Europe. It no longer is, and it is important to understand why.

From Ersatzkapitalismus to shamocracy

One reason is that “market socialism” is not working: the gregarious miracle has become a Magyar mess, despite the deceptively smart shop-windows in Budapest. Real incomes have been falling, inflation has risen to nearly 20%, and the country's foreign debt has reached almost \$18 billion, which means that Hungary owes more per person than even Poland does. This failure may seem surprising, given that in fits and starts for the past 20 years Hungary has been introducing the Soviet world's most ingenious imitation of capitalism—putting some market into Marx and pioneering the changes that are only just beginning in Russia. Yet Hungary's “consumer communism” has raised expectations without raising competitiveness. Politicians in Budapest admit that 19 out of every 20 of Hungary's manufactured products are more than five years behind average western standards.

The main cause of this (as Mr Gorbachev needs to know) is that Hungary's communist party has refused to stop its meddling. It has insisted on propping up the old-fashioned industries, such as coal and steel, which old-fashioned Marxists hold dear. If you are a factory manager in Hungary, why strive for efficiency when the state will almost certainly cover



your losses, and when the prize for making profits has been to have 97% of them taken away to subsidise the loss-makers? Ingenious as it is, the Hungarians' *Ersatzkapitalismus* is frustrated by one-party rule. Freer economics, Hungarians now recognise, requires freer politics.

It is not only in the economy that Mr Kadar's communist party has become a road-block. A monolith in an increasingly complex society, it has lost the confidence of ordinary folk. That helps to explain why so many

groups independent of party control have sprung up in Hungary: the latest are an unofficial rival to the Communist Youth League, an independent trade union for people in scientific and other institutes, and the so-called Network of Free Initiatives, which calls for multi-party democracy.

The middle ground on which Mr Kadar built his post-1956 consensus had shifted, 32 years on, in a let's-be-bolder direction. And even this new middle ground is vibrating with the rumbles from Moscow. With Mr Gorbachev in charge in the Kremlin, many Hungarians reckon they can now be braver in changing their own country. Exit Mr Kadar.

So far, however, the new leadership seems to be offering only some pretend-democracy to accompany Hungary's pretend-capitalism. The talk is of separating the party from government, of giving parliament some genuine power, of legalising some of the new unofficial groups so long as they behave themselves. The party should still play the “leading role” and yet somehow relax its monopoly of power. The proposed new economic reforms look more serious. It is suggested that private enterprises should have equal status with state ones and, remarkably, that workers should be able to own shares, even in companies they do not work in. But the political contradiction is still unsolved.

The communist party has to let go of some of its power if the reforms that might save the economy are to work, and if the pain they will at first cause is to be accepted. Mr Grosz should listen to the Budapest economists who see that true liberalisation is the only credible cure for the Hungarian disease. Hungary has to fling open its doors to foreign competition and allow unprofitable companies to go bust, even though that will mean having to pay a lot of unemployment benefit. The government has to promote, through an end to high taxes and other discrimination, the entrepreneurship and inventiveness which, from Mr Biro to Mr Rubic, have been Hungarians' greatest strength.

Is the Grosz team up to anything so bold? Reforms in Hungary have a habit of being less good in practice than they

were advertised to be. Already, doubts about the promised reforms run deep. Ideas about what wider "democracy" on the Danube might mean are woolly. At what point, for example, does an acceptable club of alternative thinkers become an unacceptable opposition party? And how serious is the proposed separation of party and state when the top people in the party are also the top people in the government? Mr Grosz himself is hardly setting a good example: he is combining his new job of party leader with his old one of prime minister. That must soon end, if he means what he says.

Realists sidle to success

Mr Grosz's commitment to reform is uncertain. He is a power-hungry realist, not a gut radical. His half-embrace of the reformers' cause is more plausibly explained as an effort to salvage one-party rule (by containing the pressures for change) than as any serious desire to modify it. Hopes have been raised by the promotion to the Politburo of Imre Pozsgay and Rezső Nyers, both more genuine democrats.

Cynics point out that it may suit Mr Grosz to have these two potential troublemakers in a position where they have to toe the collective line. Beyond Hungary, the Kremlin's new rules for what constitutes comradely behaviour in Eastern Europe are still alarmingly misty. Mr Gorbachev's patience for experiments by the East Europeans may be greater than Brezhnev's was, but it has yet to be put to the test.

Despite all these doubts, Hungary is the right country to start the testing. The demand for change comes from below, not from above, which makes it blessedly different from Russia. Whatever Mr Grosz's own views, he will be under pressure to introduce further reforms. And, once started, where would the move to democracy stop? The apparent elasticity of his beliefs could be his virtue: only commonsense, not ideological iron, will hold him back. Today's Hungary has few true believers in communism, even at the top of its communist party. Raw pragmatism rules. That is why Hungary, with its swivel-door artist out in front, is most likely to define the best New Deal under the Gorbachev gaze.

Is Wall Street bust?

Sorry to sound alarmist, but the question needs to be asked

NOBODY likes a good party to end. After more than five years of bull-market revelry and razzmatazz, America's securities firms are finding it hard to adjust to the tedium and disappointments of a bear market. Their biggest disappointment is not just that the number of shares being traded has fallen, but that most of the trading is now earning them no commission. If this continues, it will be only a matter of months before more of the too many too-highly paid people on Wall Street lose their jobs. Some famous firms will see their profits disappear. A few will go bust. American moneymen understandably fear this prospect, but they do their case no good by searching for scapegoats—like program trading and Chicago's futures exchanges (see page 79).

The truth about what is happening is brutally simple. After the speed and scale of October's crash, the most severe this century, it would have been odd if investors had not grown wary of the stockmarket. Nobody who has been burnt jumps willingly back into the fire. And cautious individual investors have been proved rational. Only in Japan's stockmarkets have prices rallied above their pre-crash levels.

Ignorant optimists say that this caution has merely reduced this year's daily trading average to 170m shares, compared with last year's 185m. The fearful pessimists among the securities firms know that two-thirds of this year's turnover is not genuine buying and selling by investors, but paper-shuffling (usually for tax reasons) among the traders themselves. As such, it generates little or no net commission.

That sounds good news, so sell

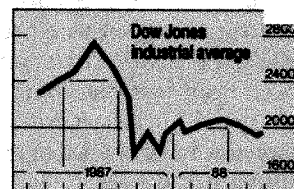
The surest proof that Wall Street is in a real bear market is the present widespread willingness to see a cloud in every silver lining. Equity prices fell after the good news that America's

trade deficit in April was only \$9.8 billion, compared with March's \$13.8 billion. Prices have weakened on a string of company reports showing buoyant first-quarter earnings, and on evidence of continuing economic growth. A year ago, each of these messages would have twisted the bull market higher. Today, the slightest rally is seen as an opportunity to sell. When a company's share price falls on the announcement of a solid rise in profits, that means the market has already discounted every possible bit of good news.

Many big institutional investors—pension funds, insurance companies, etc—are probably less pessimistic than the investor in the street: unlike him, the money that they lost in the crash was not their own. But the institutions are hold their breath, neither buying nor selling. In today's low-volume markets, fewer shares need to be traded to move prices. Bridge Information Systems of St Louis estimates that it now takes a purchase or sale of 84,000 shares to move a share 1% on the New York Stock Exchange. In January 1987 it took 155,000 shares to get the same movement. The difference is a measure of a less liquid—thus more risky—market. If the institutions decide to lighten their portfolios, prices could slump again.

There is another, more abstract fear stalking Wall Street: the unease felt by many ordinary investors that the October crash was not a computer-driven aberration but a warning of worse things to come—as market crashes have often, though not always, been. To talk of an economic slump is to be dismissed as a Cassandra, but it is true that America could not easily meet a threatened slump by trying to pump up its demand by a still larger budget deficit. That would bring frightened inflation, not recovery.

Even today, as interest rates rise because of inflation fears,



a financial crisis is brewing in America's banking and savings and loan industries. It is at its worst in Texas (see page 77) where the state's biggest bank is bust and where the liabilities of the state's thrifts exceed their assets by \$10 billion. Texas is already in a slump; its financial institutions are too fragile to withstand higher interest rates; but the markets are expecting an increase in the discount rate. Could the Texas problem become a national one?

Two other worrying questions are frequently asked on Wall Street, but remain unanswered. First, how many tens of billions of taxpayer dollars might it cost to rescue America's many insolvent lending institutions in the next recession? Second, would Congress be prepared to raise those billions,

when it is already under so much pressure to reduce federal spending—and when bankers are not much loved? So far, the insolvency of many lending institutions has not triggered withdrawals from the system because of a widespread faith in the various federal schemes for insuring deposits. But the stockmarket, perhaps the best discounting mechanism there is, is starting to reflect a view that deposit insurance is not a panacea that could be easily summoned by a chorus of distressed bankers.

Although America's economy is still growing healthily, its financial system looks horribly weak. And more people are saying that the blame for the October crash rests on that incorrigible villain, the truth.

France in step with itself



habitation, a divided executive, is dangerous. How to reduce the risk of having it again

ONE French voice the fewer in Toronto is good news for the other six leaders of the industrial world who will meet there on June 19th. It is good for France too that the not-very-socialist President François Mitterrand will speak for his country without a dissenting conservative prime minister to tug at his sleeve. Mr Mitterrand's 54% triumph in the presidential election on May 8th, and the manoeuvrings that seem almost certain to give him a Socialist majority in parliament in next month's election, have temporarily put an end to the discomfort of dealing with a dual-headed France.

But not permanently. The French got away lightly with two years of *cohabitation* between centre-left and centre-right. Other countries' constitutions—notably the American one and its many imitations—admit that the executive may come from one party while the legislature is dominated by another. But those constitutions rely on the separation of powers, and their politics is enlivened by creative tension between executive and legislature. Among the big democracies,

ly in France is executive power shared between the president and a government which, although he nominates it, is answerable to the National Assembly.

This was de Gaulle's prescription. He came to power in 1958 to rescue France from the chronic instability of feeble governments. He tailored a constitution to fit himself: as president he was to personify his certain idea of France, and give out lordly instructions to a prime minister and government who got on with the hard work. The suit made for the tall, thin man of destiny constricts the waistlines of the lesser mortals who follow him, and flops over their plump wrists.

Descartes' answer would be wrong

The vague, and very Gaullist, assumption is still that the president should master the great national issues of foreign policy and defence, the government the "details" of budgets and social policies. Some Frenchmen believe that the danger inherent in *cohabitation* would be abolished if that distinction were written into the constitution, to specify which part of the executive does what. That is too Cartesian. In the real

world no clear line can be drawn between grand objectives and the humdrum means of attaining them, between two separate and distinct compartments of executive power. A nation so many of whose policies revolve around the EEC can hardly make a neat division between means and ends. Who commands the purse, at home or abroad?

That *cohabitation* did not mean calamity was probably an accident. In the 1986 election Mr Mitterrand's Socialists lost control of the National Assembly. The president had to appoint a prime minister who mustered a majority there, and was forced to accept Mr Jacques Chirac, an old political foe. Despite the prophets of doom they managed to pull more or less together, for two main reasons. Both men (and the parties behind them) happened to agree on defence, believing that France should strengthen its nuclear force and shift its army a bit closer to its European NATO neighbours; the country had no pacifist leanings. And—until Mr Chirac flew off the handle during the presidential election—they both thought they would get more votes next time if they played things cool and looked responsible.

Mr Mitterrand played it cooler than Mr Chirac, so got more votes in the presidential contest. His bandwagon will now almost certainly carry his party through the assembly election too. Curiously, one of his cool concessions is liable to transform a comfortable Socialist victory into a landslide. Mr Chirac's centre-right coalition insisted on getting rid of the proportional voting system that the Socialists had brought in. France has gone back to first-past-the-post voting, which will unduly magnify the Socialists' gains—and, incidentally, sweep the Communists and Mr Le Pen's far-rightists into parliamentary irrelevance. Such are the ironies of politics.

But constitutions are meant to last longer than two rather lucky years. The French have managed their awkward constitution skilfully; but it is still awkward. Take the probable outlook for 1993. The National Assembly's five-year term runs out then, and the pendulum of politics suggests that the French may want to vote the Socialists out of control of the assembly by 1993. But the president's term of office is seven

years. If the present rules were obeyed, President Mitterrand would approach the fag-end of his second seven years sharing power with a hostile right-of-centre assembly and prime minister. Both centre-left and centre-right would be pushing to get their own man into the presidency in 1995. That is a recipe for bitterly divided government.

The 1993 danger will probably be averted, since Mr Mitterrand has more or less openly acknowledged that seven years (meaning 14, assuming one re-election) is too long for the presidential term. It would be simple to amend the constitution to make it five years, so that the French in 1993 can, if they wish, vote for the same party in both presidential and

assembly elections. But the risk of divided rule would reappear as soon as a future president exercised his right to dissolve the assembly before an election was due.

It would therefore be sensible to introduce, along with a five-year presidential term, one other simple change: that a president who dissolves the National Assembly should himself have to resign. He could stand for re-election if he wishes, but on the same days as people voted for the assembly. That change would give the French what they now lack, a clear-cut choice of the kind of government they want. The two legs of the executive would, with any luck, be in step, and stay in step.

Half-way to November

Bad for Bush, but too soon to announce the name of the next American president

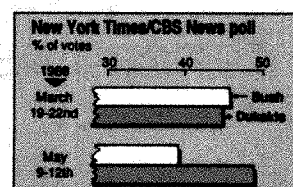
ALITTLE over five months ago Gary Hart was riding high in the polls. Today it is Michael Dukakis. The only poll that matters is a little over five months hence. Still, George Bush is deemed to be in trouble.

The favourite in May, says the *New York Times*, is the favourite in November: it has always turned out that way, ever since the *New York Times*/CBS poll was started. The fact that it was started only in 1976, that it took no surveys in May 1980 and May 1984, and that Gallup and *Time*-Yankelovich, which did, both found Jimmy Carter to be more popular than Ronald Reagan in May 1980, suggests that this piece of psephological lore would not satisfy all statisticians.

Never mind. Polls can be revealing, and much of what they have revealed this month cannot please Mr Bush. The *New York Times*/CBS poll suggests, for instance, that 28% of those who said they voted for Mr Reagan in 1984 prefer Mr Dukakis to Mr Bush this time. The Greek-American governor of Massachusetts is clearly winning back some of the traditionally Democratic blue-collar voters who defected to Mr Reagan in 1980 and, even more, in 1984. He is winning over the under-30s, the age group that swung to Mr Reagan most between 1980 and 1984. About 35% of the sample express a positively unfavourable view of Mr Bush. Indifference is one thing, hostility another.

Other polls confirm this unpopularity. Women have never liked Mr Reagan as much as men have, though they still preferred him to Mr Mondale in 1984. This year they prefer Mr Dukakis to Mr Bush, by 51% to 44% according to the Harris poll in April. Would a woman running-mate, such as Mrs Jeane Kirkpatrick, help? Maybe, but Mrs Geraldine Ferraro did not do much for Mr Mondale in 1984, when a woman on the ticket was a novelty. And Californians, who have backed a Democrat for president only twice in the past 40 years, are leaning to Mr Dukakis—by 14 points, according to a *Los Angeles Times* poll. Whoever carries California, America's biggest state, has nearly a tenth of the votes in the electoral college, in which he needs only a simple majority.

Mr Bush's problem is that, having enjoyed the benefits of his association with Mr Reagan, he is now suffering the costs.



The surprise of the primary-election campaign was that the president's popularity was indeed transferable. The surprise of the general election could be that it is not. The paradox rests on the different electorates. Those who vote in Republican primaries are Republicans—people who believe in the principles and values of the party, as well as in its most popular standard-bearer for a generation. For them, Mr Bush was the next best thing to Mr Reagan.

Gathering nuts in May

Many of those who vote in general elections are independents who vote for the man more than for his programme. Polls have consistently shown Mr Reagan to be far more popular than his policies. In pre-summer May, when the newspapers were full of star-gazing in the White House, drug-dealing in Panama and Meese-sleazing in the Justice Department, Mr Bush's name was in virtually every article. A vote for Vice-President Bush (the epithet sticks to the loyal deputy as aegis-bearing does to Zeus) is a vote for the policies, not the personality, of Ronald Reagan. They are not policies anyone would wish to run on.

Nor, if he can avoid it, will Mr Bush run on them. Hence his efforts to distance himself from the deal that the administration has been trying so hard (and eventually failing) to get as a way of detaching the adhesive General Noriega from his throne in Panama. Perhaps this will make voters see Mr Bush as his own man. Perhaps it will make them think he is being tough about drugs, the issue that more Americans put at the top of their list of worries than any other. Perhaps it does not matter all that much. Drugs are indeed widely discussed in America at present. But the fact that voters are more worried by drugs than by inflation, unemployment or nuclear war suggests that the nation is, by conventional standards, pretty contented. And when a country is pretty contented, prosperous and at peace, it is not usually in a mood to turn against those in power.

That is not to say that Mr Bush can afford to relax. He has done badly this spring, and may still have to face more Iran-contra and Panamanian embarrassments. But the press and

public are being kind to Mr Dukakis at present. They may not be for long (the polls suggest that half the voters have yet to form an opinion of him). And Mr Dukakis faces some formidable arithmetic. No northern Democrat has won more than 43% of the vote in a presidential election since 1960 (when John Kennedy scraped home with 49.7%). Since 1956 no candidate of either party has won the White House without winning a majority of the electoral votes in the 11 states of

the old Confederacy. Mr Dukakis is doing well in the South. With a southern running-mate (Senator Bob Graham helping to deliver Florida?), he might pull it off. But he will be pushed to carry Texas, without which no Democrat has ever won the presidency.

The safest prediction this year is that some old saws are destined for the wastepaper basket. Ne'er cast a clout till May is out: you may need it to wipe the egg off your snout.

Public works, private cash

A few spoil-sport thoughts on infrastructural investment

IN MOST of the world's rich countries, and in many of its poor ones, the public sector is in retreat. But it is not an orderly or logical retreat, and it is leaving behind some awkward questions about how private money can be mixed with public. The way those questions are being answered in Britain infuriates many businessmen, and quite a few of Mrs Margaret Thatcher's ministers. Their anger is misplaced, and the reasons why hold lessons for every country that has caught the privatising bug.

Many governments rush to attract private money for new roads, bridges, airport terminals and so forth. Britain's Treasury frowns on such schemes. The privately financed Channel tunnel is going ahead only on the strict understanding that the public sector is providing no underwriting or guarantee of any kind. A new privately financed bridge across the Thames got the go-ahead only over the Treasury's bleeding body. Britain's builders cannot understand this. Mr Alastair Morton, the co-chairman of Eurotunnel, calls the official attitude "the last bastion of the politics of the insane". Actually, the Treasury's insanity is to try harder than most other privatisation-loving finance ministries to prevent a damaging blurring of the public-private boundary.

ok at the customer, not the borrower

The whole argument turns on one vital point. Because the public sector's investment pays no heed to market forces, and because its debt is guaranteed against default, its capital projects must be subject to special discipline. First, each project should meet strict tests on its rate of return, so that money is not spent on roads that will barely be used or airports that serve mainly to boost the egos of politicians in marginal constituencies. And second, the government's projects taken together should be macroeconomically cautious.

This second test can be justified in different ways. An economist would say that, if the public sector borrows too much to finance its own spending, it may drive interest rates up and "crowd out" private-sector investment—investment that would otherwise have met the harsh test of viability in the marketplace. A businessman might prefer a more down-to-earth rationale: if the construction industry is already stretched and its order-book long, more projects—individually desirable though each may be—will merely boost wages and prices. Since macroeconomic policy should be aimed,

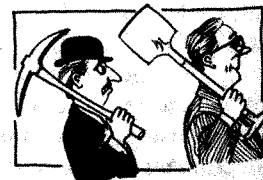
above all, at containing inflation, it cannot ignore the overall state of demand in the economy.

Very well, but what happens if the project is financed not through government borrowing but by private borrowing instead? Here, surely, is a way to build all the roads, bridges and tunnels that everybody would like, without adding to public borrowing. Let private companies raise the money themselves, the argument goes, and then recover their costs through charging. No, says Britain's Treasury: private finance for public projects must meet its rules. These insist (a) that there should be no government guarantees; (b) that cost savings within the project must offset the higher cost of raising money privately rather than through issues of public debt; and (c) "the last bastion of insanity", that the private borrowing should in effect be deemed public borrowing, and thus be subject to the government's macroeconomic targets. These rules are tough enough to scupper most proposals.

At this point, confusion thrives because two quite separate questions are usually run together. One, who is the project's customer? Two, how is the project to be financed? Contrary to popular belief, the first question matters more than the second. If the customer is the public sector, it is absolutely right to apply the Treasury's rules and tough financial standards. Because, as far as the crowding-out argument goes, it matters not a jot whether the government pays for its projects directly, by selling its own bonds; or indirectly, by letting a private company act—however ingeniously—as its financial intermediary. In short, private finance does not in itself turn a public project into a private one. It is better to view all finance for public projects as public borrowing, regardless of the intermediaries involved.

What, then, is a public project? The answer is "any project where the public sector is the customer". The Treasury therefore argues that investments made by newly privatised companies such as British Telecom and British Gas, and by Eurotunnel (private from the beginning), have no implications for the public accounts. This is dodgier ground. Yes, British Telecom and Eurotunnel are private companies. But because they are, in one way or another, regulated by government, their revenues—and hence their future profitability—are all, to some degree, in the gift of the public sector.

This leads on to the acid test. Would a government let a loss-making British Telecom go bust? Or would it alter its



rules on price-setting to help it break even? Unless the government can say "we would let it go bust", the Treasury is implicated in British Telecom's future investment decisions even though it has no direct say in them. The only way to repair this breach in the public sector's financial discipline is to ensure that there are several suppliers, so that when ministers say a company will be allowed to flop they will be believed.

This grey area, first created by the privatisation of state monopolies, is going to spread. The construction companies would like some of their plans for new roads, bridges and tunnels to be treated in the same way as the investments of British Telecom—that is, as fully private projects. But it is hard to maintain that the public sector is not the ultimate buyer of infrastructure. To see whether a particular project lies outside the scope of public spending, go back to the acid test: will the government let a bridge, road or whatever fall in a heap if something goes wrong?

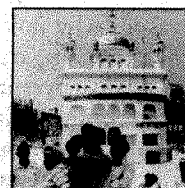
If the answer is yes (as the Treasury says of the Channel tunnel), a project that looks private can fairly safely be treated as such. If the answer is no—as the Treasury now claims of the Dartford Bridge, which it insists would have gone ahead anyway—it should be treated as a public-sector scheme. Note

that although the Treasury was unhappy about the bridge, the principle that it is a public-sector project (adding to public spending) was reaffirmed. So the affair is not the victory over Treasury inflexibility that the builders claim.

In Britain and elsewhere, privatisation is extending its reach. So is the public use of private money. Increasingly, the private and public sectors will be working alongside each other, especially where the government is keen to expand the private sector's role: health, education, housing and so on. The trickiest cases for public-sector finance will then be those where the government is both a regulator of the private producers and a monopoly buyer of their services. Under the sort of health-service reform advocated by this newspaper, for example, many hospitals would be in this position.

It will be attractive to deem such companies part of the private sector, and leave them to invest as they choose. The Treasury should let them do so—and reap the economic benefits. But it must also be willing not merely to let inefficient suppliers go bust, but to say from the start that whether they prosper or crash is none of its business. Only when governments can say that and be believed will they have pushed back the boundaries of the state.

Golden Temple, golden chance



Rajiv Gandhi's success in Punjab could be the saving of his prime ministership

IT IS cruel that Rajiv Gandhi's mettle is being tested by the issue that cost his mother her life: what to do about Punjab. It is also just. With its flashes of brilliance and its long stretches of opportunism, Mr Gandhi's Punjab policy has been typical of his prime ministership. If he can now bring peace to a Punjab that remains an integral part of India, Mr Gandhi will not only be relieving himself of a personal curse: the threat of Sikh terrorism has made the leader of the world's biggest democracy as much a prisoner of his bodyguards and security men as a felon is of his jailers. He will also be on his way to rescuing a prime ministership that has been drifting towards failure.

To speak of hope may seem grotesque when the arithmetic of murder in Punjab is getting grislier by the week. In the first three months of this year nearly 200 people were killed each month by terrorists demanding an independent Sikh state in Punjab (which is 60% Sikh and 40% Hindu); in five days in the middle of May 250 were murdered. The terrorists have long been hardened to spraying wedding guests with bullets from AK-47 automatic rifles. Now, adding economic warfare to random terror, they are murdering migrant farm workers in Punjab just as sowing season begins; the workers are fleeing in their thousands (see page 31).

Yet the latest awful spurt in the death rate follows one of the most intelligent pieces of anti-terrorist police work seen anywhere in recent years. Hundreds of armed militants had holed up in the Sikhs' holiest shrine, the Golden Temple of Amritsar, turning it into the terrorist nerve-centre of Punjab. When the same thing happened in 1984, Indira Gandhi sent

in the army. The storming of the temple achieved its military objective at the immediate cost of 1,000 lives, the anger of most Sikhs over the defilement of their shrine, and, soon afterwards, Mrs Gandhi's assassination. This time the army was kept out. Well-trained policemen sealed off the temple, turned off the water and electricity, and let the sweltering heat do the rest. The police did not tread on sacred ground, and most Sikhs were indifferent to the deaths by police sniping or suicide of a few of the militants, and the surrender of the rest. Hence the frenzy of terrorist killings that followed.

The farmers prefer ploughshares

With their attacks on the farm labourers, the terrorists have gone for rich Punjab's economic jugular. This is upsetting the large middle class of Sikh farmers, and is giving Mr Gandhi his chance to finish off the separatist threat. To succeed, he must first let the security forces hunt down and capture if possible—and kill if not—most of the 2,000 or so hardcore terrorists. This is harsh. It is also necessary: the 2,000 cannot be appeased or persuaded, only neutralised. Thanks to information picked up in the Golden Temple, the police are already capturing or killing five-seven terrorists a day. Thanks to the new-found precision of their targeting, and the anger of Sikh farmers, the police have the margin of public tolerance they need to carry out what amounts to a wartime job. Provided strict discipline is maintained—and the quality of the top security men in Punjab suggests it can be—the police should be left free to do it.

Mr Gandhi then has to drain the pool of popular discon-

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tent in which the terrorist sharks swim. His courageous stroke after his mother's murder was to promise the Sikh political party in Punjab that he would free the prisoners left over from her ill-fated Golden Temple assault, deliver the capital city of Chandigarh to full Punjab control (it is now shared with the neighbouring—Hindu—state of Haryana), and reallocate water rights between Punjab and Haryana. Mr Gandhi's corrupt Hindu-centric Congress party did not want these promises kept (might upset Haryana, you know), and he gave in. It is time to redeem the old promises and, in the next six months, to hold an election for Punjab's government, even though

this will madden the terrorists.

It is crucial for India that Mr Gandhi should succeed. Punjab, near the country's heartland, could menace India's unity if it broke up; bordering Pakistan, a Punjab in trouble poses the only serious threat of war between India and Pakistan. Punjab also matters for Mr Gandhi himself. It is characteristic of the prime minister to make the stunning start (the Punjab accord, the liberalising economic reforms, the assault on Congress corruption) and then lose interest. This time he must follow through. May Punjab be a tocsin for Rajiv, instead of the death-knell it was for Indira.

By appointment to the underclass



Britain's social workers have a feel for the urban poor that the government shouldn't ignore

SOcial workers in Britain are unloved. The popular image is of a do-gooding, long-haired leftover from the 1960s who trudges the streets in jeans and open sandals, is probably a vegetarian and still reads the *Guardian*. Right-wing politicians call them "socialist workers". They always get the blame in a child scandal. The same people who then attack social workers for leaving a vulnerable child too long with its family are ready to brand them as interfering busybodies the moment a child is taken away. Bar-room analysts say social work is unnecessary and undesirable, or that social workers are part of the problem, not its solution.

The British government shares the bar-room view. It has failed to produce a long-promised discussion document on local-authority social-service departments that might have described their changing role. Now the government has peremptorily rejected proposals by social work's central council to improve and extend social-work training and to spread it over three years, not two—allegedly because it cannot find an extra £40m a year by 1992-93. Apart from Britain, only Holland and West Germany among European countries do not have three-year training courses; theirs last for four years. America does not recognise a British qualification.

The contrast with the more popular nurses is striking. This week the government won plaudits for agreeing to improved training over three years for nurses. Nurses have just had a whopping 15% pay rise, and their career structure is being improved. Yet nursing is a curing job that (too often) degenerates into the menial and routine washing of patients and making of beds. Social work is a preventive job requiring careful decisions about clients based on training in and experience of the law, health and child care, psychology and—because other professions such as the police and doctors are involved—management skills.

The uncomfortable truth is that, in tomorrow's Britain, skilled social workers may be needed even more than nurses. Ask any children's charity. The growth of an underclass in inner cities, increased drug and alcohol abuse, racial tensions, rising crime and the spread of divorce, illegitimacy and one-parent families all mean that more children are at risk. Nor do social workers deal only with children: a third of respondents

to a recent survey said children were their main concern, 1 two-thirds cited discharged prisoners, the mentally and physically sick, and the old. As the population ages, and as mentally ill patients are discharged from institutions into society, social workers will have more to do.

Whatever it may think of social workers, the government uses them increasingly. Since 1979 it has passed 48 acts that extend their functions. Most social work is necessarily based on statute, since it can involve legal interference with families. So reliance on charities and good neighbours can never be an adequate alternative. But to give increasing authority, and increasingly complex duties, to a group of state employees is a policy that will work only if those employees are trained to use their powers sensitively and responsibly. Repeatedly, public inquiries report that they are not. Better training might have helped social workers to prevent the deaths of two little London girls, Jasmine Beckford and Kimberley Carlile, and to overrule the over-zealous diagnosis of child sexual abuse by doctors in Cleveland last year.

Helpers, not busybodies

Social workers need a better image to persuade the public (and the government) to be more sympathetic to them. They should start by learning from the success of the nurses: leave the local-government trade union NALGO, form a union or "college" of their own, and never go on strike. Next, they should welcome the idea of a "mixed-economy" welfare state in which public authorities act as agents, buying services for clients from competing public and private suppliers. Most social workers will always be public employees, but that does not justify unthinking hostility to words like choice, efficiency and value for money.

As for the government, it should rethink its bar-room view. Ministers have said that getting through to the underclass is among their highest priorities. The people best placed to do this are social workers. If the government wants them to join a new crusade using different methods, it will have to convince them that it knows what it wants to do and how. Part of the convincing will come via better training.



How Sir Yehudi Menuhin keeps time.

Throughout the world Sir Yehudi Menuhin is recognised as a truly great musician. He is equally likely to be found giving a concert with Ravi Shankar or Stephane Grappelli as with a full orchestra.

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music of each country, hence his collection of contemporary and ethnic instruments.

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time he has owned such superb masterpieces as a Stradivarius, a Guarnerius Del Gesu and a Capicchioni. He will play with one favourite for a year or so and then change to another.

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ASEA-BROWN BOVERI

Power play

Nothing is exciting European corporate and business-school strategists more than the efforts of Asea-Brown Boveri (ABB) to create a pan-European company. They see it as a case study for businesses positioning themselves for the creation of a real common market in Europe in 1992. Can this Swedish-Swiss merger succeed where so many others have failed?

"UNILEVER and Shell", says Mr Percy Barnevik, the Swedish chief executive of ABB, the electrical-engineering company with 180,000 employees and annual sales of about \$18 billion formed by the merger of Asea of Sweden and Brown Boveri of Switzerland. He is answering questions in ABB's head offices in an ugly, grey, squat building near Oerlikon railway station outside Zurich and is citing examples of successful cross-frontier mergers in Europe.

What Mr Barnevik does not volunteer is that ABB faces more obstacles to success than either of these Anglo-Dutch giants ever did, starting with the location of its head offices on the periphery of the EEC, the market that it most wants to penetrate. Asea hails from Vasteras in Sweden and Brown Boveri from Baden in Switzerland. Just about everybody in the electrical-engineering business assumed that the merged company would choose a third country ("a neutral site") for its head offices. This was apparently the preference of Asea executives. With 1992 in mind, many of them thought ABB had to opt for somewhere in the EEC. London and

Frankfurt were considered but Amsterdam was their favoured site.

Brown Boveri talked them out of it. The company, the Swiss executives argued, needed to be at the centre of things (which ruled out Sweden); but if it went to Holland, Britain or West Germany, the families of all ABB's top executives would feel like foreigners. This, they said, could prove damaging to ABB. It could not afford to have its executives distracted by problems at home while they were striving to integrate two companies that were previously fierce competitors.

Home rule

So the head office was sited in Switzerland, where Brown Boveri's prominence as a member of the business establishment has helped it to recruit and retain the most talented Swiss engineers. Swiss tax rates, too, are helpful and Zurich airport (7½ minutes away from Oerlikon) gives quick access to other European centres. This Swissness also carries a cost. As a company outside the European Community, ABB may continue to suffer discrimination in public procurement

after 1992 in those EEC countries where it lacks a subsidiary that ranks alongside domestic competitors.

This could be a big handicap in the power business, which provides more than two-fifths of the revenues of ABB (a company 50-50 owned by Asea and Brown Boveri, which retain separate stockmarket identities and a few of whose assets are excluded from the merger). National preference is such an ingrained habit that local favourites always have a definite and usually a decisive advantage everywhere—GEC and Northern Engineering in Britain, Siemens and AEG in West Germany, General Electric and Westinghouse in the United States, Hitachi in Japan and so on. In practice, the only truly open markets in the European power business are those, like Denmark and Austria, that lack a national producer.

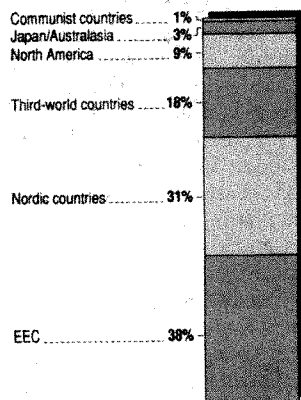
ABB, which has 70% of its sales and nearly all of its manufacturing in Europe, protests that it is the most pan-European of all companies in the business. Nonetheless the location of its head offices will give EEC countries an excuse to continue to deny it contracts in favour of their national pets after 1992 should they want to do so (and some of them will).

Apart from discrimination, ABB's great handicap is the state of the power industry. It is suffering from the same sort of overcapacity in Europe that Dunlop-Pirelli faced in their ill-fated attempt to form a pan-European tyre company (born 1971, died 1981). ABB has tried to diversify geographically by signing a memorandum of understanding with Westinghouse of Pittsburgh that gives it a stake (55% Westinghouse, 45% ABB) in two joint ventures, one in power generation

ABB's European accent

ABB turnover by market

Total: \$18bn



Number of employees

Worldwide total: 180,000

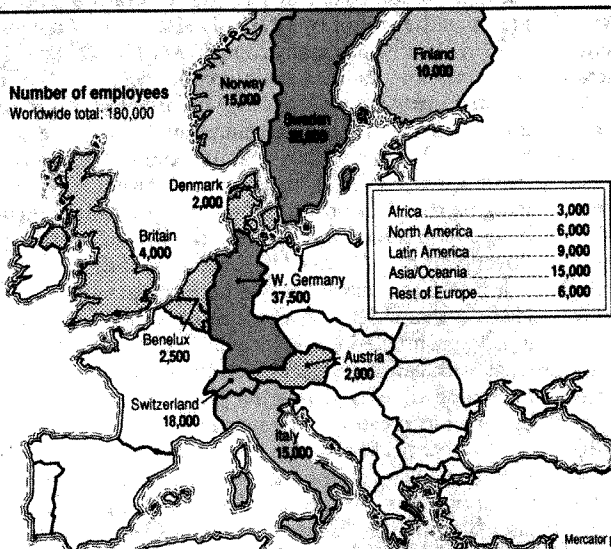
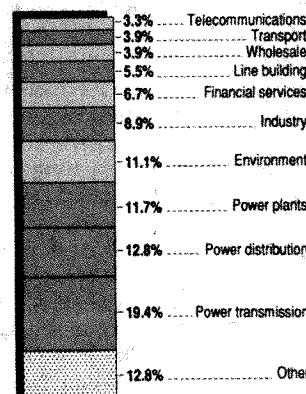


ABB turnover by sector

Total: \$18bn



Source: Company reports

ASEA-BROWN BOVERI

and the other in power distribution and transmission equipment.

In effect, the deal gives ABB access to Westinghouse's trademark and its American utility customers for \$500m. That, say analysts, is far less than Brown Boveri has spent failing to break into the American market, where the foreign entrant has to come in at least 15% cheaper than a domestic competitor to have a chance of winning a utility contract.

The snag with these joint ventures is that the American market is even more depressed than the world market. Not a single order for a new power station was placed in the United States last year. In Western Europe, where the Chernobyl scare has put many nuclear programmes in doubt, the power industry's overcapacity problems are also severe.

ABB seeks solace in calculations that demand for power is still growing by about 2% a year in industrial countries and by 6-8% in the third world. It reckons that the prospect of brown-outs and blackouts will eventually persuade utilities to order new capacity. The upturn is expected to come first in the United States, where by 1990 about 100 gigawatts of power generation will be 30 or more years old, the age of senility in this business; by 2000, some 300 gigawatts will be 30 or older. But in any business that is a long wait. How is ABB going to keep itself busy and profitable while waiting for world demand to pick up in its core business?

Unconventional wisdom

Mr Barnevik observes with satisfaction that ABB's main competitors are fast diversifying into consumer electronics, defence equipment, even medical products to reduce their dependence on electrical-engineering in general and the power industry in particular. For Siemens of West Germany, electrical-engineering equipment now represents only about 40% of total sales, for General Electric of America 30%, for GEC of Britain 45% and for Hitachi-Mitsubishi Electric-Toshiba (which others in the industry see as one great Japanese rival) 25-50%. For ABB the figure is 100% and its chief executive is delighted to find himself swimming against so strong a tide (for Mr Barnevik the way to make money in manufacturing, as in the stockmarket, is to invest when everybody else is fleeing).

His C.V. makes it impossible to dismiss this as bravado. Though he looks like an earnest American professor of a slightly obscure social science—social geography, perhaps—Mr Barnevik has proved himself the most successful of the young managers produced by the Wallenberg companies. Morgan Grenfell, a London merchant bank, en-

thus about the record of Asea since 1980 when the Wallenbergs, who own just about everything in Sweden, shifted Mr Barnevik from Sandvik, a Swedish metal-bashing company, to become boss of Asea.

Mr Barnevik, who was then 39, cut costs, stressed market-driven R&D and set up profit centres with tight and ambitious targets. Sharper cuts at the top than the bottom helped to sustain morale on the factory floor—Asea's head-office staff in Stockholm was reduced from 1,700 to 200, with an eventual target of 100.

Sales have increased at a compound annual rate of 18% at Asea since 1981 when



Barnevik and sidekicks: Leutwiler (top) and Nicolin

Mr Barnevik got a grip on the company and net profits at a compound rate of 13%. As-tute takeovers of companies in neighbouring countries (Stromberg in Finland, Flotech in Denmark, Elektrisk Bureau in Norway) have changed Asea from a Swedish-centred into a pan-Nordic electrical multinational. It is an impressive record even by the high standards of Sweden, where devaluation of the kronor by 10% in 1981 and by 16% in 1982 helped many companies to become far more internationally competitive.

In his new job at Oerlikon, Mr Barnevik is emphasising profits over volume and market share. He wants, above all, to avoid ABB signing new contracts at inadequate profit margins that lock in unprofitable capacity before he has had time to make the Brown Boveri part of the merged business as fit and as lean as he has already made the Asea part. He fears that if ABB does not turn away marginally profitable business it will find itself stuck with capacity that would much better be scrapped, so squandering the greatest opportunity created by the merger.

Rubber-neckers from other companies watching ABB for pointers on how to restructure a business in preparation for 1992 are fascinated by the way the Swedes at Oerlikon (the Swiss are less ruthless) seem imper-

vicious to unpopularity as they push through their changes. Swiss engineering concerns report that for the first time ever they are finding it possible to head-hunt employees that Brown Boveri would like to keep.

All this upsets old hands at Brown Boveri. But, when pressed, they admit that radical change is overdue. Before the merger Brown Boveri had what are euphemistically called two "dividend-free years". Because it was engineer-driven, with R&D aloof from marketing, Brown Boveri's profits had been sliding since the late 1970s. According to a devastating analyst's report from Morgan Grenfell, the company did not possess "even an effective matrix organisation. In many countries each subsidiary had its own management structure, undertook its own marketing, research and production, thus duplicating costs and dissipating strategy."

When Mr Fritz Leutwiler, the head of the Swiss National Bank from 1974 to 1984, was appointed chief executive in 1985, profits were tiny. Even so, his promise to shareholders to double profits in 1987 compared with 1986—when Brown Boveri had net profits of SFr96m (then \$53m) on sales of SFr13.8 billion—and to increase them by a further 50% in 1988 looked beyond reach when the merger with Asea was finalised on January 1st this year.

Mr Leutwiler stays on as co-chairman of the board of directors of ABB. In this role he will probably serve the same function as Mr Paul Volcker, the former chairman of America's Federal Reserve, or Lord Prior, a former Tory minister in Britain, do when they join companies—they have excellent contacts and have their telephone calls returned by people in governments and central banks that their new employers want to consult, charm or cajole. The other co-chairman is Mr Curt Nicolin, a famous Swedish engineer who sits on the boards of several Wallenberg companies.

The restructuring that Mr Leutwiler started will be made more sweeping and will be pushed through by Mr Barnevik at a faster pace: the conversion of Brown Boveri from a geographical to a product divisional structure; the facing down of the Mannheim operation, which had become an independent power within Brown Boveri; the establishment of about 3,000 profit centres at ABB. The profit centres will have much autonomy in purchasing and will be close to their markets and their customers (which means short decision lines).

The new Swedish managers from Asea are younger and more entrepreneurial than most of their counterparts from Brown Boveri. They knowingly play the averages, setting ABB, say, 200 objectives in the full realisation that if they achieve 140 or 150 of

Growth opportunities worldwide

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them their exercise will be fairly judged as a triumph.

In setting the objectives, the new managers have an advantage (often poorly exploited in a merger of like with like) of being able to compare every operation of the two companies to discover the leader in each field of activity—in throughput, quality, failure rates and so on. Confronted with superior achievements at a rival company, divisional chiefs customarily say that they know for a fact that these results are being obtained at a tremendous loss. "ABB now has all the data—there can be no more of that sort of bullshit," says one of its executives.

Restructure, then grow

The restructuring will include the concentration of ABB's 11,000 R&D employees—5,000 of whom hold advanced academic qualifications—in three main centres (Vasteras, Heidelberg and Baden) and six smaller ones. Their cohesion is essential to ABB's aim to become the low-cost producer in all of its businesses.

Power remains the core business, and both parties to the merger have great strengths to contribute at the cutting edge of power technology. Asea, for instance, contributes pressurised fluidised bed combustion (PFBC), an efficient, cheap and environmentally sound way of burning coal; and it is the world leader in high-voltage direct current systems. Brown Boveri's high-temperature reactor stabilises at a safe temperature, diminishing the risk of a core meltdown.

Niche opportunities are being opened up in ABB's other businesses by the excellence of its R&D effort. It challenges Japan in the manufacture of industrial robots. In locomotives ABB is already the main "domestic" supplier to the Swiss, Scandinavian and (through Brown Boveri Mannheim) West German railways. Its expertise in mass-transport systems is producing pay-dirt, and an analyst at Goldman Sachs, a New York investment bank, notes that ABB has produced a high-speed train that, unlike Japan's Bullet and France's TGV, operates on existing track, thus cutting costs.

In environmental controls the thin operating profits of the Fläkt subsidiary that Asea has contributed to the merger should be fattened as stricter anti-pollution standards cause more utility, forest-product and motor companies to seek its help. The potential for synergy between Fläkt's environmental expertise and ABB's power-plant operations is large and can be properly realised now that the largely complementary technical strengths of Brown Boveri and Asea are being integrated.

By opting for international standards of accounting (a tactful way of saying Nordic transparency rather than Swiss opaqueness), ABB will make its operations more intelligible to its own people as well as to

outsiders. It reckons that the cost of revealing hitherto confidential information to its competitors will be more than offset by the clearer sense of direction that this gives to the company's own employees.

ABB has chosen the dollar as its accounting currency and English as its working language. Only 15% of ABB's employees have English as their mother tongue, and for all members of the executive board it is a second language. But, as few of Asea's people speak Switzer-Deutsch (a dialect described by its detractors as more a throat infection than a language), ABB had no option but to plump for the foreign language that Swedes spoke most fluently.

The restructuring and synergistic ambitions of ABB look daunting but achievable. Doubt about the merger begins to emerge only on the marketing side. As a manufacturer of capital goods that has governments as its main customers, ABB is at a disadvantage compared with consumer-products companies. When Electrolux, a Swedish white-goods multinational, acquired Zanussi of Italy it was able, if it wanted, to transfer the production of washing machines from Italy to France, or refrigerators from Sweden to West Germany. Nestlé, a Swiss chocolate maker, will have a similar opportunity to shut inefficient operations and concentrate production in efficient factories if it wins its contested takeover fight for Rowntree, a British rival based in York.

The market test

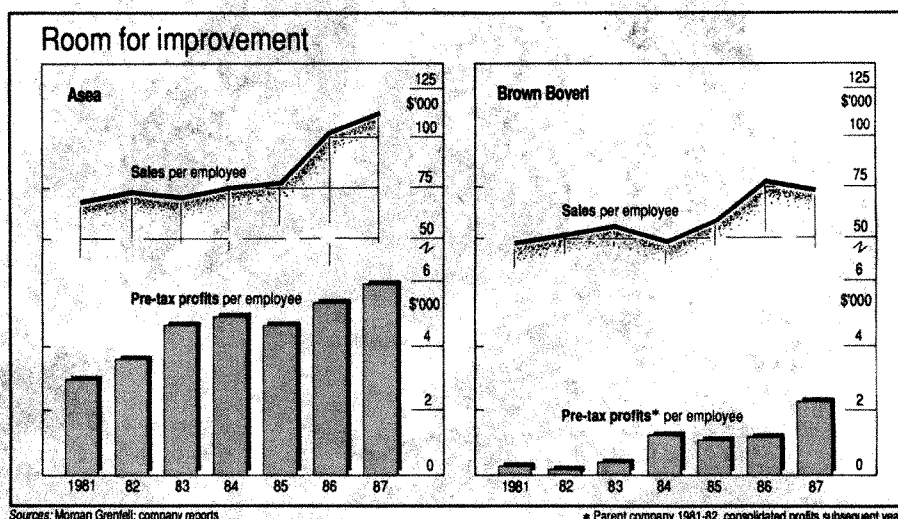
ABB's room for similar manoeuvre is cramped. It realises that it has little chance of winning a contract from a statal or parastatal body in an industrial country in competition against domestic rivals unless it has a significant manufacturing base in that country. It has already shot itself in the foot by putting its head office in Zurich. If the EEC really does create an open market in 1992, or something approaching one, symbolism could be important. Though ABB has factories dotted throughout the Commu-

nity, it will not look or smell or taste quite like a pukka EEC company so long as all its main centres—Vasteras and Stockholm for Asea, Baden for Brown Boveri, Zurich for ABB—are all outside the Community.

ABB's strategy to break into third-world markets also provokes a nagging doubt. The company already has 30,000 employees in the third world, most of them in India and Brazil. It talks of having many more as it expands its Indian and Brazilian operations and increases its presence elsewhere, especially in East Asia.

Soured by the experience of European shipyards, ABB wants to be part of the infrastructure when the newly industrialising countries come on stream in the heavy electrical-engineering industries that are its core. ABB's aim is to operate in the third world as "an insider, not invader". Joint ventures in South Korea and Taiwan are cited as the shape of things to come. The growth is certainly there—demand for power in the newly industrialising world is growing three or more times as quickly as in the old industrialised ones. Only a shortage of foreign exchange and of credit is stopping these countries from giving ABB more business.

Scepticism persists, nonetheless. When, analysts ask, did a multinational company last make a decent profit on its operations in the third world? Ford's troubles in Argentina, Volkswagen's in Brazil and just about everybody's in China come easier to mind than the success stories. The American market ambitions of ABB also look unconvincing. Perhaps the joint ventures with Westinghouse will give ABB the opening into the world's largest utility market that Asea and Brown Boveri have so long craved—but do not count on it. In the electrical-equipment field, Westinghouse has run a distant second to General Electric since God was a boy. Is it possible that ABB will pass every other test only to fail the one that really matters—test of the marketplace?





Trigger-happy in Singapore

FROM OUR SOUTH-EAST ASIA CORRESPONDENT

WHAT has gone wrong with Lee Kuan Yew? In the 29 years he has led Singapore he has shown a decisiveness and far-sightedness that put most other politicians, anywhere, to shame. His ideas and the firm hand with which he put them into practice made Singapore prosperous, modern, efficient and practically corruption-free. Dissent was never welcome, and politics was mostly the preserve of Mr Lee and his party. This did not keep him from being popular: most Singaporeans were content to leave the politics to him, because he was giving them comfortable lives. It was a fairly relaxed relationship.

It is now much less relaxed. Singapore is turning into the sort of place where you do not say bad things about the top man without glancing around to see who is listening. It is far too strong to say, as some have said, that the city-state is becoming Orwellian. But critics of the government now worry about who is reading their letters and listen-

ing to their telephone conversations. Prisoners are not physically tortured in Singapore. There is not much violence, and no race riots. But the flavour has got unpleasant.

Things soured last year, when Mr Lee started launching broad attacks on dissenters. Restrictions were placed on the circulation of foreign publications that had displeased the government (by refusing, for example, to publish an unedited rebuttal by a government spokesman of an article the paper had printed). Some woolly-headed but apparently harmless people, many of them Roman Catholics and social workers, were alleged to be part of a Marxist plot. They were detained without trial, all but one were released after they had "confessed"—and seven were rearrested last month after claiming the confessions had been coerced.

This month Mr Lee took on the United States. An American diplomat was accused of meddling in Singapore's politics and sent home. He had talked to a former solicitor-

general, Mr Francis Seow, about Mr Seow's plans to enter politics. America responded with a tit-for-tat expulsion, and the campaign against foreign conspiracies was on. "Beware foreign elements," admonished one newspaper that follows the government line: "they are out to attack our psychological and social defences."

Mr Seow, a critic of Mr Lee, was for his part arrested under the Internal Security Act. Besides talking to the American diplomat and thinking about running for office, Mr Seow had been representing some of the alleged Marxists in court. He had also written an article for the *Asian Wall Street Journal* (one of the restricted publications) arguing that Singapore had become a closed society. Mr Seow is still in jail.

Now Mr Lee is tangling with an old comrade-in-arms, Mr Devan Nair, a former president, who says the prime minister should resign. Mr Lee accuses him of collaborating with Mr Seow. Mr Nair, who should be in a position to know, retorted this week that, like Mr Seow now, Mr Lee back in the 1960s had himself talked to foreigners about domestic politics. Defamation, snapped the prime minister, who is demanding an apology and damages from Mr Nair. Even if he complies, Mr Nair, who perhaps prudently has been out of the country since the row began, may still be in deep water. One opposition politician is being asked for hefty damages because his apology for slandering Mr Lee during an election campaign was "neither sincere nor unreserved".

Why is a prime minister whose party has all the seats but one in parliament, and who has a calm and wealthy country behind him, behaving like this? It is rash to push back democracy, and invite hostility from western friends and nervousness from foreign investors, when there seems to be nothing at all threatening the stability and prosperity of your country. All around East Asia, particularly in Taiwan and South Korea, countries are liberalising their politics as they become richer. Mr Lee is bucking the trend.

The prime minister is not mad, or senile (he is only 64). But he has been in power for a long time, the force of his personality and intellect almost unchallenged over the years. A man in that position does not gladly brook dissent. And, as always with Mr Lee, deeper calculations are at work. One is his growing conviction that democratic freedoms are likelier to hold Singapore's economy back than propel it forward.

That is an odd view of an increasingly rich and information-based society. And foreign investors increasingly do not share it: one of Hongkong's top businessmen, fa-

That demob feeling comes to Kampuchea

FROM OUR SOUTH-EAST ASIA CORRESPONDENT

NOW Vietnam, too, is saying there's no place like home. On May 25th, ten days after the Russians started leaving Afghanistan and four days before the Reagan-Gorbachev summit was to open, the Vietnamese announced that they will withdraw 50,000 soldiers from Kampuchea this year; they start leaving in June. Every year since 1982 Vietnam has pulled out some men, most recently 20,000 last November. But these were simply troop rotations. The total announced this week, more than a third of the 140,000 Vietnamese believed to be in Kampuchea, may mark a serious change of policy.

The announcement follows a visit to Moscow last week by General Prem Tinsulanonda, prime minister of Thailand, which borders Kampuchea and gives sanctuary to the anti-Vietnam resistance. The general spent 45 minutes with Mr Gorbachev, talking about Kampuchea. Russia has been thought reluctant to lean too hard on the Vietnamese because of the value of its bases at Da Nang and Cam Ranh Bay. Yet Mr Gorbachev told General Prem that he would at least talk to Vietnam about withdrawing.

Vietnam's foreign minister, Mr Nguyen Co Thach, was then summoned to Moscow. He may have been reminded yet again of the bitter truth that Russia pays a lot of Vietnam's bills (\$3m-worth a day) and that Vietnam is too hard up to afford its Kampuchean adventure. The heat may really be on the Vietnamese to make a deal and get out by their promised deadline of 1990.

How might it happen? General Prem was keen in Moscow to revive the idea of a "cocktail party", a chat among the local

powers. Vietnam and the three resistance groups would mingle with the Kampuchean government of Mr Heng Samrin. The Russians seem agreeable, but nothing will budge until the Vietnamese talk directly with Prince Norodom Sihanouk. He leads the resistance and is the only Kampuchean figure with enough authority to bless a settlement, and to make it palatable to the West. So far Vietnam has not wanted to get down to serious withdrawal talk with the prince.

Then there are the Chinese. Their main aim is to whittle Vietnam down to size. They also have the Russians to think about. Vietnam's occupation is the last of the "three obstacles" China has said are

stopping normal relations with the Soviet Union. It may not be unreservedly happy to see the removal of this convenient excuse for spurning Mr Gorbachev's proposal of a Chinese-Soviet summit.

The Vietnamese will be reluctant to go if it means leaving Kampuchea to the Khmers Rouges, the most powerful section of the resistance. It was to depose them that Vietnam invaded Kampuchea in 1978. The Kampuchean army is not strong enough to take on the Khmers Rouges alone. There has been talk of an international peace-keeping force, but nobody takes that idea too seriously. Bon voyage to the 50,000; but Kampuchea is still a long way from Afghanistan.



Maybe it's for real this time

miliar with Singapore, says that foreign businessmen are already thinking twice about the place because of what is going on there. But Mr Lee knows that one ingredient in Singapore's success has been a strong, nimble government that could respond quickly to changing business conditions without the bother of a troublesome opposition. He wants to keep the option open.

Another factor is doubtless Mr Lee's worry that Singapore's present stability could prove deceptive. The place has a racial mix which, in Mr Lee's eyes, makes it easy for hatred and chaos to be whipped up by irresponsible journalists. The country is 75% Chinese, 15% Malay, the rest a mixture. Neighbouring Malaysia has allowed more freedom than Singapore and has had more racial tension. The neighbours in themselves are a cause for concern: mostly-

Chinese Singapore is ethnically isolated, wedged between big and Muslim Malaysia and huge and Muslim Indonesia. Would a less regimented Singapore fall prey more easily to disorder or hostility from across the border?

Mr Lee's crackdown may be timed to help the ruling People's Action party win the next election. There has been so much hounding of the potential opposition that few intelligent Singaporeans will risk taking on the ruling party without thinking carefully about the consequences. Mr Seow was thinking of setting up a group of lawyers to run against some of the People's Action candidates. That idea was crushed when he was arrested. The atmosphere has grown so bad that some Singaporeans believe the government will even know how they vote.

The majority is unlikely to be restive

when the election comes around (most people think it will happen in December). For all Mr Lee's faults, many Singaporeans still like him and call him a great man. Any votes cast against the ruling party will probably be muffled by a new system of "team members of parliament" which, the government says, was introduced to ensure a racial balance in representation. The opposition will be hurt by it. As many as a third of the candidates will have to run in threes. Finding three candidates in a constituency will be easier for the large machine of the ruling party than for the small and fragmented opposition.

It is thought the prime minister will step down at election time. But that may change little. Mr Lee will probably become president. That is now a ceremonial post, but not for long: legislation is in the works to make the president popularly elected, and proba-

bly more powerful. Whichever of the two main candidates succeeds him as prime minister—his son, Brigadier-General Lee Hsien Loong, now the trade minister, or the deputy prime minister, Mr Goh Chok Tong—it is Lee Kuan Yew's vision of Singapore that will stamp the character of the place for years to come. The troubling thing for those who have admired Singapore, and Mr Lee, is that the vision, for reasons hard to understand, is darkening.

India

The temptations of sainthood

FROM OUR INDIA CORRESPONDENT

TO MATTER that Mr Rajiv Gandhi is at last achieving some success with his jhab policy; his Congress party is getting nervous about the growing unity of India's opposition. If Mr Vishwanath Pratap Singh can lead the opposition into battle in the general election due next year, it has a real chance of defeating Congress. But there is that if. Mr Singh has had trouble making up his mind whether he wishes to be a politician or a saint. He has been consulting his *antaratman*, the soul within his soul, to find the answer.

Mr Singh was the ablest of Mr Gandhi's cabinet ministers, holding first the finance and then the defence portfolio. He was forced out last year after probing into what he called "the nexus between big money and politics". He said he would never seek office again, but would devote himself to cleansing Indian politics of corruption. He created the Jana Morcha (People's Movement), which was not quite a political party but more than a social reform movement.

Last July Mr Amitabh Bachchan, a film star and a close friend of Mr Gandhi, resigned from parliament, where he represented Allahabad, because his name had been dragged into financial scandals involving his brother. Mr Singh, who also comes from Allahabad, said at first that he would not contest the by-election caused by the resignation. Then he filed his nomination papers, assuming that Mr Bachchan would stand again: he considers the Bachchans the personification of all the evils he is fighting against. The film star seemed eager to accept the challenge, but instead Congress took the wily step of nominating an uncontroversial candidate, Mr Sunil Shastri, the son of a respected former prime minister. Mr Singh, his scruples aroused, debated with himself over whether to pull out of the race. It was only at the last minute, on May 26th, that he made up his mind to stay in.

About time, muttered other opposition politicians. As they see it, Mr Singh is their

Even in Punjab, that may be too much

FROM OUR INDIA CORRESPONDENT

THE Sikh terrorists in Punjab may be learning a hard lesson: that one defeat is liable to lead to another, if you react in panicky hysteria. The Indian government's success in forcing the surrender of the armed militants who had occupied Amritsar's Golden Temple not only destroyed the insurgency's main control centre. It also led those Sikhs who bloodily search for a separate state to make the first big blunder in their five-year campaign.

In the five days after the surrender, on May 15th, of the main body of militants in the temple, Sikh terrorist gangs killed 245 people in Punjab, most of them Hindus. More than 60 were migrant farm labourers from eastern India. They were chosen as victims partly because they were easily identified as Hindus, and shot in batches as they slept in their camps. In turning their guns on them the terrorists have struck at the vitals of Punjab's economy. The state's sturdy Sikh farmers, whom the separatists have been wooing ever since they began their campaign, will suffer grave

losses and are likely to be enraged.

Reports from Punjab suggest that migrant workers are already leaving the state in droves. More than half of the workers at a large canal construction site have abandoned their camps, and many farm labourers have also fled. Even escape was perilous. Terrorists set off a bomb in a railway station waiting room that was packed with migrants waiting for trains to take them out of Punjab; four were killed and 20 wounded.

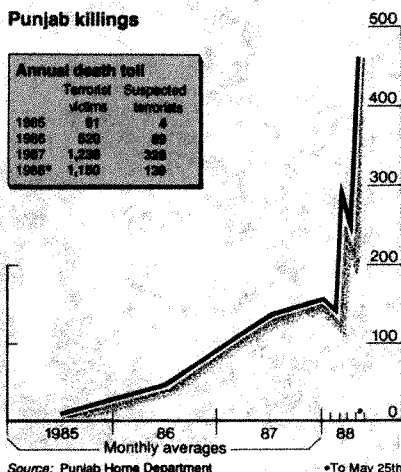
In a normal year, the next few weeks would see a large inflow of seasonal labour to Punjab. It is now a safe bet that the supply will dry up. This could spell ruin to thousands of farmers. Ever since they began to cultivate paddy, Punjab's farmers have depended heavily on migrant labour from eastern India's rice-growing states to sow, transplant and harvest the crop. So great is the demand for seasonal labour that almost half a million migrants come to Punjab every year.

A cut in their numbers will sharply increase the cost of labour. It may even cause an absolute shortage during the transplanting season, which is only six weeks away. The area under paddy is bound to fall, and the farmers who continue to plant it are likely to find most of their profits swallowed by higher wages.

Paddy is now the main cash crop of nine-tenths of the farmers in Punjab. The typical small farmer retains most of his wheat for consumption by the family, but sells all his rice. He will be hard hit by the lack of migrant labour. Since eight out of ten farmers in Punjab fall into this category, the terrorists will lose a lot of friends in the coming months. If the attacks on migrant workers continue, modern Punjab's hard-won prosperity—the fruit of 40 years of patient toil—could be ruined within a year.

Punjab killings

Annual death toll	
Terrorist victims	Suspected terrorists
1985	81
1986	600
1987	1,238
1988*	1,180



leader, Allahabad is his home town, and he should have an easy win. Mr Gandhi's most powerful opponent would enter the Lok Sabha, the lower house of parliament (Mr Singh is now a member of the upper house). Allahabad is the second city of India's largest state, Uttar Pradesh. Congress politicians who control the state parliament would get a forceful message about the drift of public opinion. Many would cross the floor and others would be demoralised. Since Uttar Pradesh elects almost 20% of the Lok Sabha's 546 members, whoever wins there is likely to form India's next government.

The opposition has good reason for its

hopes. Even though Mr Gandhi himself remains pretty popular, the Congress party is linked in people's minds with corruption, nepotism and high-handedness. State after state has slipped out of the Congress grasp. The whole of the south, the east and the north, comprising nine of India's 16 major states, is in the opposition's hands. Only the Hindi-speaking states of the centre and three others remain with Congress. By winning in Allahabad on June 16th (when there will be 17 other national and state by-elections in a big trial of political strength), Mr Singh could give the edifice of Congress power just the push needed to bring it tumbling down.

That would not be the last of the opposition's problems. In the past ten years, as the voters have become disenchanted with Congress, they have voted against it in state elections but not in national ones. They have not forgotten that the Janata coalition, voted into power in 1977 as a protest against Indira Gandhi's "emergency" rule, fell apart in less than three years.

Only Mr Singh, the argument goes, can make the opposition seem like a possible alternative government. He was an able chief minister of Uttar Pradesh from 1980 to 1982. During his tenure as Mr Gandhi's finance minister he was loyal to his chief and willingly shouldered the burden of unpopular decisions. Most people see him as a man of principle, yet able to control a fractious party. He is the right one to carry the opposition's banner—if he has, in fact, decided to serve India as a politician rather than a saint.

Taiwan

The events of May

FROM OUR CHINA CORRESPONDENT

ON THE island of Taiwan, political tolerance is new and fragile. Is it about to be shattered? Since last July, when martial law was ended after 38 years, street demonstrations against the government have been running at an average of three a day. In the Legislative Yuan, or parliament, members of the Democratic Progressive party, the technically illegal opposition, hurl abuse and sometimes even punches at aging representatives of the ruling Kuomintang. Through it all the government has remained calm—even during the delicate days in January when President Chiang Ching-kuo died and Mr Lee Teng-hui was appointed his successor. Taiwan, it seemed, was on the path to liberal democracy.

So one still hopes. But on May 20th the patience of the government was perilously strained. More than 3,000 farmers marched through the capital, Taipei, to protest against the import of cheap American food and to demand a social insurance scheme for farm workers. As the marchers reached the parliament building, the demonstration turned nasty: at least 40 people were injured, many of them policemen. Some observers say it was the worst political violence since the notorious "incident" in the southern city of Kaohsiung in 1947, when Kuomintang troops from mainland China massacred thousands of native-born Taiwanese.

Just why matters should have turned so ugly is an open question. Taiwan's farmers, who number only 700,000 of the island's 19m people, do feel aggrieved. They have

Leaning on Lini

EVEN a speck can have a leadership struggle. Will Mr Walter Lini, the prime minister of Vanuatu since the Pacific island-state won its independence in 1980, give way to Mr Barak Tamé Sopé? If Mr Sopé gets the job, will he continue Mr Lini's dissenting approach to life, which has made Vanuatu the nonconformist of Pacific politics?

Probably he would be more radical. The causes that Mr Lini has articulated—against the continuation of French colonial power and nuclear testing in the South Pacific, against poaching by foreign fishing boats—are Mr Sopé's, too. The two men have long provided the intellectual fuel of the ruling Vanuaaku party. But these causes are beginning to look a little tired. Mr Sopé wants to promote a federation of Melanesian states (Vanuatu, the Solomons, Papua New Guinea and Fiji) which would have a louder voice than Vanuatu's alone. The group would give strong support to Melanesian indepen-

dence movements in the French colony of New Caledonia and the Indonesian province of Irian Jaya.

The rest of Melanesia is unenthusiastic about the idea: the island peoples are separated by great distances and have little in common except the deep black skins from which their ethnic name is derived. All the same, the Melanesian cause is a good platform on which to campaign for the presidency of the Vanuaaku party and thus the prime ministership.

Mr Sopé, who is general secretary of the party, challenged Mr Lini unsuccessfully for the top job after last November's general election. He claimed that Mr Lini, who suffered a stroke earlier in the year, was not well enough to rule. Last week some 2,000 of Mr Sopé's supporters marched on the capital, Port Vila, complaining of injustices in the use of land. Several people were injured and one was killed, seemingly accidentally. Land is an emotional subject in Melanesia, where, by tradition, it is not supposed to be sold, but is—usually to well-off Australians for holiday homes. Australia, probably unduly alarmed, said it was prepared to send a warship to evacuate its citizens.

Mr Lini, and Mr Sopé if he succeeds him, will have to be wary about upsetting foreigners. Vanuatu is attempting to diversify away from foreign aid for its income: it is advertising itself as a tax haven, a tourist centre and a flag of convenience (70 ships on the register so far). On May 23rd Mr Lini sacked Mr Sopé as minister of tourism and immigration. Any bid for power will, he says, have to wait for the party election in 1989. However, Mr Lini went to New Zealand in January for medical treatment, and may go again. If Mr Sopé thought Mr Lini was too unwell to carry on last year, what will he think now?



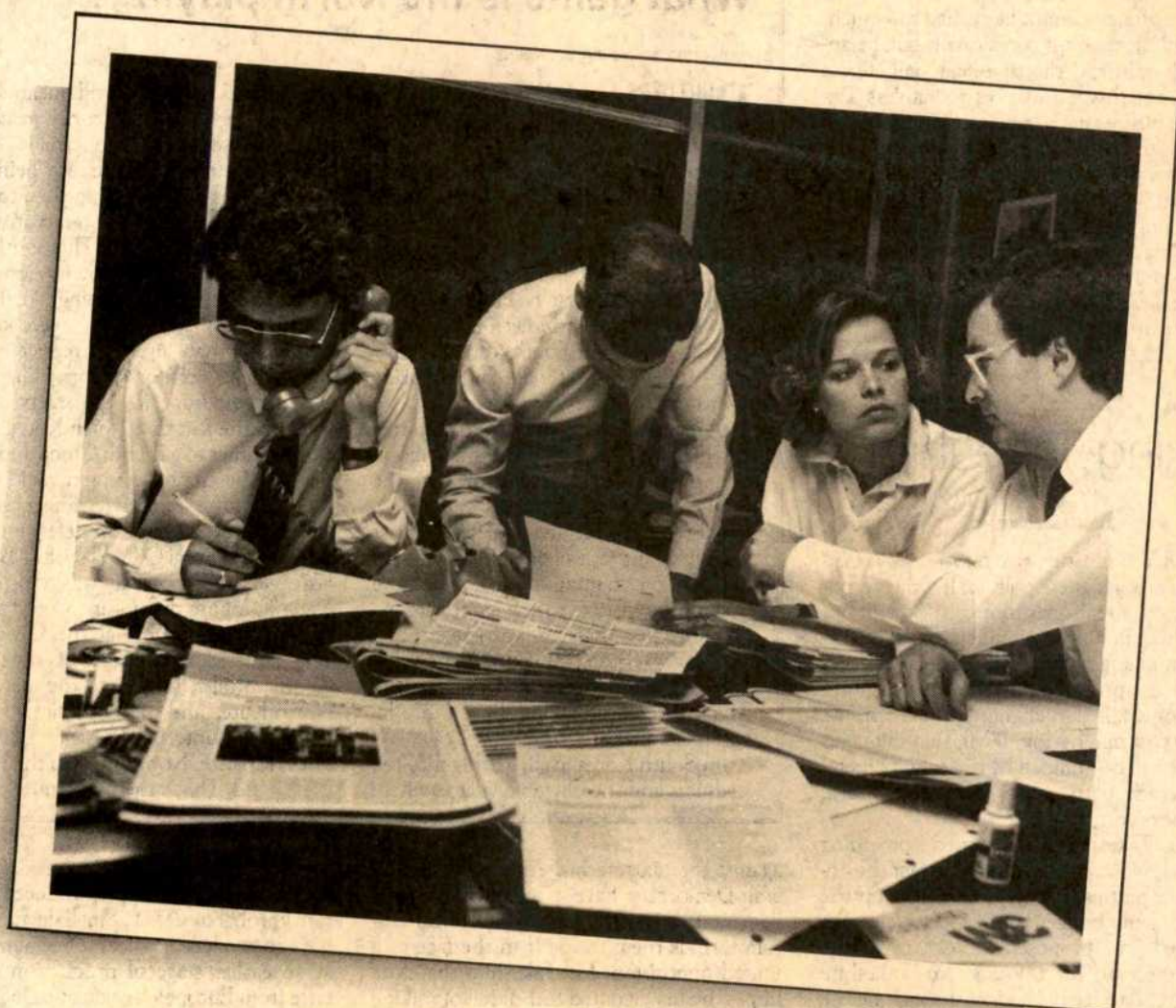
Lini's causes are tired, too

been left behind in Taiwan's breakneck race to prosperity; they consider the freer imports of American fruit and poultry a betrayal of their interests for the sake of placating a powerful Uncle Sam grown weary of America's perpetual trade deficit with Taiwan. Certainly, too, the Democratic Progressives used the demonstration to insult President Lee and the ruling party. And, quite possibly, Kuomintang hardliners may have acted as agents provocateurs to discredit the government's liberal experiments.

The most alarming experiment for the old guard is the cracking of the political wall that separates Taiwan from China. Forty years after Mao Zedong shoved Chiang Kai-

shek and his troops to their offshore retreat, the implausible dream that the Kuomintang will one day recover the mainland remains official dogma. Recent events make light of the dogma. Taiwan's citizens can now go, via Hongkong, to visit relatives on the mainland; mail can be sent and received by the same route. Indirect trade with the mainland is running at \$2 billion a year, mostly in favour of Taiwan. And when a Chinese aircraft was hijacked to Taiwan earlier this month, it was expeditiously returned to the mainland with minimum embarrassment to China's government.

The Kuomintang stalwarts who hate this blurring of the faith are dying off. Presi-



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ASIA

dent Lee is trying to speed up the attrition by offering handsome retirement pensions; but the process cannot be rushed too much. The old-timers must occasionally still be appeased—witness the five-year jail terms meted out this month to two hapless Taiwanese businessmen convicted of trading directly with the mainland. The power of the anti-reformers may be sharply curtailed after July 7th, when the Kuomintang holds a party congress at which perhaps half of the elderly nay-sayers will step down. It will be a pity if violent demonstrations like the one that followed the farmers' march breathe new life into the old guard.

Japan

Taxing Takeshita

FROM OUR TOKYO CORRESPONDENT

ONLY one issue, tax reform, now matters in Japanese politics. It is messy, but it poses the real question: can Mr Noboru Takeshita, in his own cumbersome way, succeed in changing what his sprightly predecessor as prime minister, Mr Yasuhiro Nakasone, failed to change? Mr Nakasone's failure cost him his job. If Mr Takeshita fails too, he will be dumped by the ruling Liberal Democratic party when his two-year term ends next year.

Mr Takeshita has learned something from Mr Nakasone's upset. Last year the opposition parties in parliament held up the government budget until Mr Nakasone dropped a proposed sales tax, the centrepiece of his reforms. Mr Takeshita was careful to see his budget through before the special session of parliament which is due to debate his tax bill in July.

The opposition parties are united



No surrender, Takeshita promises

What game is the North playing?

FROM OUR TOKYO CORRESPONDENT

PERHAPS North Korea's leader, Mr Kim Il Sung, means it when he says his country will not disrupt September's Olympic games in Seoul. Nobody feels entirely trustful. Even if North Korea (which is not taking part in the Olympics) does not cause trouble, there are others—notably the terrorists of Japan's Red Army—who may be happy to do its dirty work. Hence a quiet international effort involving the South Koreans, Japanese, Americans, Chinese and Russians to ensure the games' security.

A South Korean-Japanese committee has met in Tokyo to discuss collaboration on anti-terrorist measures in the run-up to the games. Japan could be a terrorist target because athletes from at least 35 countries will be doing their final pre-Olympic training there, and because 80% of the visitors to the games are expected to pass through Japanese airports on their way to Seoul. The Japanese police have arrested two Red Army members suspected of having slipped into Japan to commit sabotage.

In South Korea itself, getting into the stadiums and the Olympic village, where

the athletes will live, will mean being checked by doorframe x-ray machines and other security paraphernalia. Some 60,000 electronic gadgets are being installed. Dogs are being imported to sniff out explosives. Sixteen anti-terrorist task forces have been set up. The South Korean and American soldiers along the demilitarised zone separating North and South Korea will be on even keener watch-out than usual. American warships will be alert for seaborne idiocies.

The best hope for the safety of the games is the fact that North Korea's two closest things to a friend, China and Russia, will be there. It would make little sense for the North to anger either. When the North Korean defence minister, Vice-Admiral O Jin U, visited Beijing last week, he reportedly was told by Mr Deng Xiaoping that China would take a poor view of trouble at the Olympics. The American secretary of state, Mr George Shultz, has raised the matter of North Korea and the Olympics with his Soviet counterpart, Mr Edward Shevardnadze. Now it is up to the North to be good. That's the problem.

against the tax reforms. Although the Liberal Democrats have a comfortable parliamentary majority, Japanese political custom forbids them to use it in the face of a united opposition. Mr Takeshita therefore hopes, by his favoured technique of talking quietly to a wide range of contacts, to shear the small, centrist Democratic Socialist party away from the rest of the opposition.

The prime minister is getting public opinion on his side. At public meetings, and with the help of a pliant press, he has put over the message that the taxes of the future will have to pay for more pensions and medical care as Japan's population ages. The present tax system bears down disproportionately on wage-earners. Mr Takeshita wants to shift part of the burden to indirect taxes. He seeks big cuts in income tax and other taxes—cuts worth ¥6 trillion a year (\$48 billion), according to hints given on May 24th by the party's number two, Mr Shintaro Abe. The party's supporters in big business are being offered the sweetener of lower company taxes. The 10,000 biggest companies paid a tax bill of ¥26 trillion (\$209 billion) in the latest tax year.

Full details of the new tax should become public in mid-June, when the ruling party's tax committee is due to complete its draft proposals. They had been promised earlier, but haggling is still going on over possible exemptions. What the committee

has in mind is a value-added tax with some special twists. It will be introduced at a low rate, probably 2-3%. Small firms will not have to produce invoices to reclaim tax paid at an earlier stage of production (a difference from Europe); a calculation of their tax liability will be made from their account books. Many small firms keep two sets of books, the more self-effacing version of which is shown to the taxman. Mr Takeshita's new tax could be a tax-evader's deli-

The prime minister may have to make other concessions. Financial and insurance transactions have wriggled out of the proposed system. Other lobbies will seek special treatment. Then there are the opposition parties. They scent blood since Mr Takeshita's indecisiveness in tackling two recent matters. He was slow to sack a senior cabinet minister, Mr Seisuke Okuno, for suggesting that Japan was not the aggressor in its invasion of China in the 1930s; and the deadlock with America over quotas on imports of beef and oranges is still unbroken.

Even if he succeeds in winning over part of the opposition, Mr Takeshita may need to give the rest a way of saving its face. Parliamentary politics in Japan involves much ritual struggle. The betting is still that Mr Takeshita will scrape through with his tax reforms; but the opposition parties will make him sweat it out until the end.

AMERICAN SURVEY

High spirits but low hopes for Moscow

WASHINGTON, DC

WHEN Ronald Reagan became president, summitry was out of fashion, the Russians ruled an evil empire and America wanted more missiles, not fewer. Now, near the end of his term, he describes the Soviet leader as a "friend", and he is off to the empire itself to talk about turning half America's missiles into ploughshares, while Russian troops retreat from Afghanistan. Once they have shaken hands in Moscow this weekend, no American president will have met his Soviet counterpart more often. At his fourth meeting with Mr Mikhail Gorbachev in 30 months, Mr Reagan becomes the fourth American president to visit the Soviet Union and the first for 14 years (since Mr Gerald Ford in 1974).

Nobody expects the Moscow summit to produce either a new idea or a new treaty to be signed by the two leaders. Tacitly admitting this, they have told their negotiators in Geneva to take a month's holiday after the summit. The joint statement to be released at the end of the meeting is already drafted. It says little different from the one that ended the Washington summit last December. Several small treaties may be ready to be signed during the visit, but not by the leaders: two that deal with pollution and search-and-rescue in the Arctic, or others dealing with fishing, nuclear explosions for peaceful purposes, advance notice of ballistic-missile tests and reciprocal monitoring experiments at nuclear test sites.

In other words, this summit will be exactly the kind of getting-to-know-you-better exercise that Mr Reagan once said he abjured. No sense of urgency attends this gathering, and none of the mutual recrimination about who is dragging his feet that usually precedes a summit.

It was hoped last December, when the present meeting was planned, that this would be the occasion to sign a treaty cutting long-range arsenals in half. But the strategic arms reduction talks (START) have produced no treaty yet, and the treaty banning land-based nuclear missiles that travel between 500 and 5,500 kilometres had still not been ap-

proved by the Senate as Mr Reagan left for Russia. This is the agreement, known as the intermediate nuclear forces (INF) treaty, that was signed in Washington in December.

The Senate's approval is needed for its ratification, but the treaty was bogged down until mid-week in a morass of ingenious amendments, mainly from Senator Jesse Helms. Mr Gorbachev, according to Mr Helms's first amendment, was not empowered to sign such a treaty because he is not a head of state and has not sought the permission of the president, Mr Andrei Gromyko (as Mr Brezhnev did of Mr Podgorny in 1972). After Mr Helms had conceded defeat, on May 25th, hopes rose that a ratified treaty might yet catch up with the president before he reached Moscow.

None of December's other hopes has come to anything. Yet nobody predicts a diplomatic catastrophe. The Americans, like the Russians, seem content to go on

talking. The only failure they fear is one of public relations, and both sides are relying on the charm of the two leaders and the picturesqueness of the settings to avoid that.

Even when the trip is largely ceremonial, American presidents do not travel light. Aircraft have been shuttling to Moscow all week with equipment for the 600 members of the administration whose presence is considered indispensable at the summit. This includes everything from Mr Reagan's limousine to the Californian wine to be served at the dinner he gives in the American embassy. The scouts sent out to assess Moscow's creature comforts came back with dire tales of the lack of shower curtains and the inadequacy of Soviet soap—and with upset stomachs. So shower curtains, soap and water are all on board the aircraft.

Having had a dress rehearsal in Washington, the Russians were ready to meet most of the Americans' logistical demands. They were not upset that Mr Reagan decided, unlike Mr Richard Nixon, not to stay in the Kremlin, and they recognised the need to prepare for an invasion by a greedy and demanding press corps. The only change they made to the Reagans' schedule was to add a small private dinner at the Gorbachevs' *dacha*.

Part of the reason for a quiet summit is that both sides have achieved their immediate objectives and neither is yet convinced that the next step is in its interest. The Russians have (or soon will have) got rid of the hated Pershing missiles that could reach Moscow from West Germany, and have gained the sort of international respectability they crave. The Americans have (or soon will have) got rid of the SS-20s and the invaders of Afghanistan.

They have also seen Mr Andrei Sakharov released and emigration from Russia increase just a little. Mr Reagan has been going out of his way to praise the Russians' progress on human rights, welcoming the easing of censorship and the reuniting of divided families. Nonetheless, detente it is not, say American officials. The relationship is one of pragmatism, "engagement", not friendship. The talks are professional where once they were polemical, says Mr Michael Armacost of the State Department. That cuts both ways. "We must react to *perestroika* as cold, calculating capitalists, not as romantic capitalists," says Senator Bill Bradley.

Before they take the next step,



Could they be made into shower curtains?

AMERICAN SURVEY

the Americans need to make up their own minds about several things. Chemical weapons, they insist, cannot easily be banned in a way that can be verified. Cuts in conventional forces may come eventually, but will first need a long and careful set of negotiations. Besides, the Americans still link this issue with improvements in human rights, simply as a way of keeping human rights on the agenda. And, of course, there is always the Strategic Defence Initiative, which, if all goes well, will barely even be discussed at the summit. The Americans refuse to abandon their "broad interpretation" of the anti-ballistic missile treaty; the Russians refuse to recognise it. The entirely ambiguous language of the December statement allowed both sides to feel they had stuck to their guns. Expect an almost identical remark this time.

The three biggest issues directly holding up START concern mobile missiles, air-launched cruise missiles and sea-launched cruise missiles. America has until now maintained in the START talks that mobile missiles must be banned altogether because it is impossible to verify a partial ban of such an elusive quarry (a position that has its ancestry in the INF talks). Yet the Americans are beginning to recognise that the Russians have invested too much in mobile missiles to agree. At the same time Congress is arguing over plans for two different mobile American missiles.

The Senate—and Mr Frank Carlucci, the defence secretary—prefers the option of putting the big, ten-warhead MX missiles already under development on to rail cars. The House of Representatives prefers developing a new, single-warhead missile, the Midgetman, that carries its own launcher with it; this is a neater but more expensive option. The House-Senate conference on the defence authorisation bill will probably allocate each \$500m, thus underlining America's indecision about its mobile missiles. Mr George Shultz said on May 24th that the Americans would propose at the summit a way to keep track of mobile missiles rather than banning them altogether.

A reluctance to move too fast has kept other obstacles in the way of a START treaty. Mr Henry Kissinger has persuaded the administration to worry that fewer missiles could mean more Soviet warheads aimed at each American launcher—and so a bigger temptation to launch a first strike. The foolishness of having built Trident submarines so big (each can carry as many as 192 warheads) that any cut would leave America with a mere handful, each stalked by packs of Soviet attack submarines, is now dawning on the Defence Department. And, although it may conceivably be possible to distinguish a nuclear from a non-nuclear sea-launched cruise missile by allowing the other side to inspect it and literally seal it shut, this would inevitably destroy America's habit—

essential to keeping certain allies sweet—of neither confirming nor denying whether its ships carry nuclear weapons.

Altogether, therefore, there is no enthusiasm for haste on START. Moreover, the more Mr Reagan and Mr Gorbachev talk, the less American voters worry about arms control. One of the biggest issues in 1980 and 1984, East-West relations have simply sunk below the political horizon this year, to be replaced by drugs and trade. Mr George Bush and Mr Michael Dukakis both promise they would pick up START where Mr Reagan leaves off. Only a few diehards on the right object. Such unanimity between Democrats and Republicans in an election year is almost unprecedented.

The attention, then, will switch elsewhere. To space, perhaps (see page 73), or Africa? Rumours of a breakthrough on Angola blossomed briefly in the weeks before the summit. But, as they left for Moscow, members of the administration were talking more soberly about merely hoping to restart the London talks and muttering that Russia could no more control Cuba than America could control South Africa. Other regional issues were to be talked about with no great optimism. Kampuchea runs into Vietnamese objections, Nicaragua American, and the Gulf war Russian. There should be plenty of time for sightseeing.

America and Panama No deal

WASHINGTON, DC

GENERAL MANUEL NORIEGA, commander of the Panamanian Defence Forces (PDF), has yet again placed the Reagan administration in a quandary. On May 25th he turned down an elaborate American proposal which would have secured his resignation in return for the dropping of

drugs charges against him in the United States. The administration will now have to continue its pressure on Panama in the hope that the general will eventually leave, or be forced out of office by Panamanians, knowing that in doing so it may cause lasting damage to the Panamanian economy and stir up anti-Americanism.

The secretary of state, Mr George Shultz, had delayed his departure for Helsinki, en route to the Moscow summit, in order to try and reach an agreement. But General Noriega would not sign the compromise that his representatives had negotiated. "No further negotiations are contemplated," Mr Shultz said. "Our proposals are withdrawn."

The idea was that General Noriega would announce in a speech that he would resign on August 12th, the sixth anniversary of his appointment as PDF commander. Within ten days parliament would restore civil and political liberties. He would support the establishment of a "government national reconciliation" that would guarantee that the next presidential election, due in May 1989, was free.

After his speech he would answer questions and announce that he intended to leave the country soon after August 12th and to stay out of politics. He would not return to Panama, except for a brief Christmas visit, until after the election. The drug charges would be dropped immediately after he resigned. The agreement would be deposited with the Papal Nuncio in Panama.

Against the odds, General Noriega has managed to keep Panama's economy moving for much longer than expected, despite the freezing of the Panamanian government's bank accounts in the United States and other economic sanctions. Yet the sanctions are doing some damage. The general's bargaining power may be diminishing.

He may, however, keep going for while. Some firms have brought money in Panama to pay their workers. The general



may be using part of his personal fortune to pay the PDF. The Canal company is paying its employees with dollars. The government is paying its employees with \$50 cheques that are accepted by supermarkets (although they do not give change). And Mexico, ever opposed to United States intervention abroad, carries on supplying Panama with oil without demanding prompt payment. Banks, which had closed for lack of dollars, have reopened. Customers can withdraw 25% of their current accounts or \$10,000, whichever is the larger, over 90 days, and \$50 from their savings accounts.

The Reagan administration, embarrassed by the failure of its sanctions, will have to continue its policies or become tougher. But it does not want to ruin Panama's economy. Might it be rescued by a coup? "Our information is that there are significant splits in the PDF," the State Department's Latin American specialist, Mr Elliott, said hopefully this week. "Most in

PDF recognise that Noriega is a burden on the PDF and the country that has to be lifted." But the general has already survived one coup.

The administration's Panama policy has been beset with problems from the start. Mr Abrams has suggested several drastic actions to remove General Noriega from office but has been over-ruled in heated debate by the

defence secretary, Mr Frank Carlucci, who worries about the risks.

Vice-President George Bush, equally worried about the damage that the affair is doing to his standing, has picked on policy towards Panama to set a distance between himself and the president. "I won't bargain with drug dealers, whether on American or foreign soil," is his line. He has been politely ignored by most of the administration. His view is shared, however, by the federal prosecutors in Tampa and Miami who have won grand-jury indictments against the general, and who are supported by the attorney-general, Mr Ed Meese.

The Senate has got a word in by approving, by 86 votes to ten, a resolution opposing any deal to dismiss the indictments in return for the general's resignation. The resolution was sponsored by the Republican minority leader, Senator Robert Dole. But even critics admit that the Senate has not offered any solution of its own.

Through these events, the Panamanian people have not had much to say. General Noriega would not allow that. Opposition newspapers and some television stations have been closed. Demonstrations have been banned. Panamanians await decisions about their fate, knowing that whatever happens, they are going to be poorer.

Massachusetts

Home of the budget-balancer

BOSTON



Dukakis swears this isn't 1975

IT HAS long been the boast of Governor Michael Dukakis that he can balance a government budget. "I've balanced nine budgets in nine years," he likes to say. In fact, on the ninth his luck has run out. This year Massachusetts has a large revenue shortfall: something between \$250m and \$5 billion, depending on whom you believe. The governor and his allies insist it is of no great significance—that revenue forecasts can easily turn out to be wrong, and that the budget can be put right. But Massachusetts's Republicans and conservative Democrats can barely suppress their glee. The governor's cover is blown, they say. He is a tax-and-spend liberal. And where Massachusetts opponents of Mr Dukakis tread, Vice-President Bush is sure to follow.

Budget troubles are not new to the governor. The last time they beset him, during his first term in office, they defeated him. Is this a replay of 1975? No, says Mr Dukakis. The economy of the state is basically healthy now; this is a one-time shortfall.

The governor's aides argue that Massachusetts is in good company: New York and California have similar fiscal problems. And they blame the current difficulty on the unexpected consequences of federal tax reform and a "glitch" in the state's own corporate excise-tax system. His critics have a different explanation: "The problem is not a revenue shortage. It's excessive spending," says the Democratic chairman of the state House of Representatives' taxation committee.

Since 1983 the state budget has grown by more than twice the rate of inflation, say

Degrees of zero tolerance

AMERICA'S anti-drug campaign is in danger of making a fool of itself. For two months the country's drug-busters, in particular the Coast Guard, have been following a policy known as "zero tolerance". The idea is to deter drug takers as well as drug salesmen by no longer turning a blind eye to the possession of small amounts of drugs. Government officials have been seizing cars, lorries and boats in which even the slightest trace of illegal drugs is found.

More than 1,000 vehicles and boats have been confiscated since the policy was adopted on March 21st. Some of the seizures seem a bit out of proportion to the crime:

- The *Ark Royal*, a \$2.5m yacht, was seized in international waters and confiscated after 3 grams of marijuana were found on board by Coast Guard officials who had boarded her. None of the people on board was arrested. The yacht was released after the owner's representative paid \$1,600 in fines and seizure fees.

- A woman was arrested at the Canadian border and had her car confiscated after customs officials used tweezers to extricate one-tenth of a gram of marijuana from her handbag.

- The *Atlantis II*, an \$80m research ship owned by the highly respected Woods Hole Oceanographic Institute, was seized when customs officials found traces of marijuana in a crew member's shaving kit, along with a couple of "dope" pipes. The vessel was returned after the institute agreed to write a letter supporting the anti-drug campaign and promised to be more careful.

The seizures have led to some bad publicity for the Reagan administration's anti-drug campaign. Civil libertarians dislike what they see as the use of sledgehammers to crack nuts and it has also been noticed that the policy of zero tolerance evidently does not extend to General Noriega.

On May 23rd the administration relented—a bit. No longer will boats be seized outside the 12-mile territorial limit if they are found to have small amounts of drugs on board. Only those boats clearly attempting to bring drugs into the country will be confiscated.

But within the 12-mile limit, the frenzy continues. The Customs Service's latest suggestions include putting America on an anti-drug "war footing", even going as far as selling "drug-war bonds".

AMERICAN SURVEY

the critics. They contend that more than 5,000 new employees have been added to the state payroll, with numbers in the executive branch alone growing by 18%. They also accuse the Dukakis administration of seeking to hide its embarrassment by sleight of hand. Already in February, they claim, it was quietly withholding legally appropriated funds amounting to nearly a tenth of the budget, hoping thus to balance the books.

Whatever the cause, at the moment revenue and spending are out of kilter. On that everyone agrees. What is to be done? The budget must be balanced; it is the law. And no one wants the poor marching in the streets or, worse still, a tax increase, a return to "Taxachusetts" as the state was called in Governor Dukakis's first term.

"We are going to cut back... In fact, we're not going to cut back; we're not going to expand as rapidly as we had hoped to do," Mr Dukakis has said. He got it right the first time. Inevitably some programmes, and perhaps the executive branch, will be cut. Several programmes due for expansion are already getting less than expected.

The search is on for new revenues too, ideally the sort that nobody notices. The House has already voted to align the state and federal tax codes (placing new limits on depreciation allowances and business expenses, among other things) and to increase the tax on cigarettes. Debate has begun on other "sin" taxes: on alcoholic drinks and luxury entertainment, for instance. The governor is opposed. He would prefer to increase the fees charged by various state agencies and suggests raiding the state's stabilisation fund, created just a year ago. "That's what it's for," he argues. "What do you have reserves for but to dip into them from time to time when unexpected things happen?" His critics reply that the "rainy day fund" was meant to help only in a recession. Where's the recession? they ask.

The governor's office has also proposed using cash reserves to make up revenues. The repair of state buildings and other projects would in turn be paid for by state bonds rather than cash. But the chairman of the House committee on ways and means, a loyal Democrat, has already expressed concern over existing levels of debt service.

Mr Dukakis suggests he welcomes the crunch as a chance to show his stuff. But his nationally advertised hands-on managerial capabilities may not be much on display. The skills of the legislature may be more evident. The leaders of the legislature have no wish to hand Mr Bush ammunition. While the governor has been on the road, they have been taking charge. They fixed up a universal health-care bill, and will fix up the budget too—until November at least. By then Mr Dukakis may have a new job, and the legislators will have put their own elections behind them.

San Francisco

Agnos agonises

SAN FRANCISCO

THE new mayor of San Francisco, Mr Art Agnos, spent his first few months in office brooding. A serious fellow, he was unenthusiastic about such popular local causes as a new ballpark or a bid to play host to future Olympics. His inclinations were to do something for the 40% of the city's population classified as minorities—blacks, Hispanics, Asians. They had helped to elect him last December and, as recent events in San Francisco have shown, have had cause to expect some help in return. But they have had to compete for the mayor's attention with the city's budget, now sporting a deficit of \$180m. To reduce it, Mr Agnos has decided to hire no new city employees until the workforce is cut by at least 400, perhaps by as many as 1,000.

The mayor argues that, with 27,000 employees serving 749,000 people, San Francisco has a higher ratio of public servants to population than any city in the west. Yet the cuts are bound to hurt minorities, by reducing both services and job opportunities. The exact size of the cuts will partly depend on whether the voters give their approval to a tax increase on June 7th. If so, Mr Agnos will spare the fire and police departments from the axe.

The fire department is of particular concern to him. The city's firemen are good at putting out fires but bad at hiring black colleagues. Last November, after long litigation, the city and civil-rights groups agreed on a goal for promotion and hiring. The agreement was fiercely opposed by the local firemen's union.

In January, a few days after Mr Agnos was inaugurated, there was a series of ugly incidents. A black fireman was erased from a photograph of firemen honoured for bravery. A swastika was drawn on a station that included a black, an Asian and a Jewish fireman. A long-serving fireman, Mr Frederick Postel, the acting deputy chief for operations, was roughed up by fellow firemen in a bar, apparently because of his readiness to train women and minorities.

These incidents were brought before Judge Marilyn Patel, of the federal district court. She denounced the department as "out of control" and threatened jail and fines if discrimination is not curbed. The chief fireman, Mr Edward Phipps, promptly resigned, putting the department's future in Mr Agnos's hands.

Mr Agnos came under pressure to appoint a black fire chief. He declined to do so. But he did promote Mr Postel to be the new chief, and Mr Postel has promised to open the fire stations to women and to minorities. The mayor's new appointments to the city's



Smile and hiring both frozen

fire commission, which has authority over the department, are supposed to ensure that the fire chief keeps his word. The commission's president is Mr James Jefferson, a property developer who heads the Black Chamber of Commerce. He is supported by members who are concerned with civil-rights, anti-poverty and lesbian issues.

Concerned, yes. But all the king's horses and all the king's men will not be able to see that members of minority groups are hired if there is a freeze on hiring in the fire department. Mr Agnos is campaigning hard for the tax increase to extract him from his dilemma.

Chicago

Whose kind of town?

CHICAGO

IN ANY other city, reporters would have been expected to ask Mr Shimon Peres, Israel's foreign minister, about violence in the Middle East and Palestinian unrest. Not in Chicago. When Mr Peres met the press on a visit to the city on May 12th the first questioner sought his reaction to a more parochial matter, the "Cokely affair".

Cokely is Mr Steve Cokely, a black aide to Chicago's black mayor, Mr Eugene Sawyer. The previous week it had been revealed that for three years Mr Cokely had been casting slurs on Jews and Christians in lectures to followers of Mr Louis Farrakhan, the black nationalist head of the Nation of Islam. It was a measure of the controversy's impact that Mr Peres already knew of it.

During the lectures, which were taped,

Mr Cokely denounced Israel as a "wicked beast" conspiring to control the world, said that Jewish doctors were injecting black babies with the AIDS virus, and called the crucifix "a symbol of white supremacy". It took Mr Sawyer five days to come to a decision to fire his aide after being approached privately by Jewish leaders, and he acted only after the story had become public. The city, with roughly as many blacks as whites, furiously debated such matters as the mayor's vacillation, whether Mr Cokely's right to free speech had been violated, whether the mayor had acted rashly or under Zionist intimidation, and so on.

At about the time of Mr Peres's visit, a second controversy broke, dwarfing even the Cokely affair. Five black aldermen commandeered several city policemen and marched into Chicago's world-renowned Art Institute, demanding the removal of a satirical painting which was on private display in a section closed to the public. The painting, "Mirth and Girth" by Mr David Nelson, depicted Chicago's first black mayor, the late Harold Washington, clad in women's underwear. When officials refused to take down the painting without Mr Nelson's permission, the police confiscated it. When the painting was released three days later, it had a large gash across it, leading to a suit against the city on Mr Nelson's behalf by the American Civil Liberties Union.

Again, the city erupted in a heated debate. An untrue rumour spread among blacks that Mr Nelson was Jewish, a supposed explanation for his desecration of the memory of a black political hero. A chorus arose among blacks and whites alike that the Art Institute had been to blame for recognising as art something that was not—a curious argument, suggesting that American constitutional protections against unlawful search and seizure cover only items of artistic merit.

The city council threatened to cut off

money for the institute. An alderwoman threatened to spray paint over the painting if it reappeared. A local householder said he would shoot anyone who tried to remove any painting he might choose to hang on private property outside his home. And the president of a black self-help organisation proposed that vigilantes should examine all paintings in the Art Institute and demand the removal of those they did not like. The directors of the institute took out advertisements in Chicago's two main newspapers apologising for insensitivity to blacks and promising preferment programmes to increase the numbers of black students (a seemingly unrelated issue). The directors were denounced by student groups and patrons of the arts for failing so cravenly to defend artists' rights of self-expression.

As for Mayor Sawyer, he has appointed an inter-racial, inter-faith commission to try to reduce tensions and mend black-Jewish relations. It faces a formidable task.

Rubbish

Burning question

WASHINGTON, DC

IN ONE corner of the American economy supply is steadily exceeding demand: garbage production. Americans are churning out rubbish at the rate of 200m tons a year, and they are voting and demonstrating not to have that same rubbish dumped or burnt anywhere near them. An environmentalist, nowadays, is somebody who campaigns against municipal incinerators and landfill dumps. His legacy includes the bargefuls of American rubbish now being offered around the world to anybody who will buy them.

Well supplied with land and reliant largely on private enterprise to get rid of its rubbish, America has for a long time taken the cheapest option in waste disposal: 90% of its rubbish is simply dumped in landfill sites and buried. But landfill sites are filling up; a third have closed since 1980. More than half the cities on the east coast will exhaust their sites by 1990. In New York 14 sites have closed in the past ten years. All of Seattle's sites will soon be full.

The first effect of this squeeze is that the price of disposal has begun to take off. In Minneapolis the cost has risen sixfold in six years. In California it is expected to hit \$1 billion before the end of the decade. The residents of northern New Jersey are paying up to ten times as much for the removal of their rubbish as they did a year ago. New Jersey and Pennsylvania bribe local residents to accept landfills nearby. Desperate cities are shipping the waste across state lines and in some instances sending it abroad. It is rarely welcome. A notorious barge, the *Mobro*,

with its tug *Break of Dawn*, spent two months in 1987 hawking a pile of 3,100 tons of best New York rubbish around the Caribbean before returning home with it.

New Yorkers throw out nine times their weight in rubbish each year. The city puts most of the 24,000 tons of waste it produces each day into a landfill at Fresh Kills on Staten Island, the largest dump in the world. It generates 5m cubic feet of methane a year, enough to heat 50,000 houses and, at the rate it is growing, will soon be the highest hill on the east coast south of Maine. But Fresh Kills is rapidly filling up and is already breaking all sorts of environmental regulations by exuding contaminated water. The city has no new site to replace it. The only answer other than recycling (on which the mayor proposes to spend \$25m next year, compared with \$4m this year), it says, is to build an incinerator in each of New York's five boroughs at a cost of \$3 billion a year. The incinerators would take 70% of New York's waste.

Other cities are already investing in incinerators. They have obvious attractions. They reduce the waste to ash and thus cut its volume by nine-tenths. And they produce heat and steam, which can be used to generate electricity. Several companies have made steady profits from operating incinerators, making money at both ends: charging cities for the rubbish they burn and charging utilities to take the power they generate (which the utilities must by law). About 70 such plants are in operation, 20 are under construction and 100 more are planned.

Yet less than 5% of America's waste is burnt. Cities have discovered that incinerators are much more unpopular even than landfills. They put out several nasty pollutants including hydrogen chloride and, worse, dioxin. The pollutants can be dealt with by fitting scrubbers, but only at a cost that forces their operators to add at least a half again to the price they charge to burn the waste (about \$30 a ton). Unless obliged to, few incinerators do fit scrubbers.

The result is local fury when a plant is built or planned. Not in my back yard, cry the locals. Residents of Los Angeles have prevented any being built in their city. In Massachusetts, Governor Michael Dukakis has earned the wrath of environmentalists through his support of incineration. Massachusetts has ten plants in operation and eight planned, which will be enough to burn half the state's rubbish. But the president of the state Senate, Mr William Bulger, has forced Boston to back down from its plan to place a big incinerator near the city. The state, taking the hint, has now offered Boston incentives to build a recycling plant instead.

Philadelphia has learned another lesson. Because the ash from incinerators may contain dioxins and heavy metals, it cannot be put into normal landfills. (The Environ-



Sawyer settled for a commission

Of sick buildings and bureaucrats

WASHINGTON, DC

LIKE many modern buildings, the headquarters of the Environmental Protection Agency (EPA) in Washington, DC, has windows that cannot be opened. An increasing number of the agency's employees have been suffering from nausea, dizziness, sore throats and skin rashes, all of which clear up at the weekend. The EPA, it seems, occupies what scientists have come to call a "sick building". In order to find out more about such buildings, and treatments for the sicknesses they cause, the Senate environment subcommittee has passed a bill instructing the EPA to undertake a study. Physician, heal thyself.

The more buildings breathe, the more of their heating or cooling goes to waste. When energy prices rose after 1973, it became patriotic to cut demand for oil by reducing the amount of air taken in from outside. But the less fresh air that is taken in, the more people have to breathe each other's germs, dust, fumes, pesticides and moulds. The World Health Organisation has reported on the hazards of sealed buildings, pointing out that many seem to make people ill. Yet only in 1981 did the American Society of Heating, Refrigeration and Air Conditioning set a standard for the minimum amount of fresh air that

should circulate in a building, and even that was voluntary.

Lack of fresh air is not the only cause of trouble. Many buildings contain materials that should never have been allowed in—to kill cockroaches or glue down carpets, for example. Sometimes air intakes are found to be right next to rubbish bins, or nicely placed to take in traffic fumes.

For some reason Washington seems especially affected. The National Institute for Occupational Safety and Health, which has a watching brief over federal buildings, readily admits to it. In order to save money, it says, building engineers turn off fresh-air vents. The offices that housed the assistant secretary of health and his staff had to be closed a few years ago because of polluted air. Investigations revealed that one vent system ran over a pool of stagnant water, where it picked up all sorts of fumes and bugs.

So far, the federal government has been more absorbed by a few notorious pollutants such as radon and asbestos than by bugs in buildings. That may change, if the Senate subcommittee gets its way and ensures that \$49.5m is spent on research over the next four years (the EPA is to spend just \$300,000 on indoor-



air pollution problems this year).

But lawyers may catch builders' attention before the government does. In Santa Barbara a plaintiff recently sued 200 defendants—including an architect, a building contractor, a ventilation engineer and the makers of such products as floor tiles, glue and carpets—claiming that his health had been injured by the air in which he worked. The suit was settled for \$700,000, a sum big enough to make others want to match it. A newsletter called *Indoor Air Pollution* is now being published, a sure sign of a boom market. Developers are hiring indoor-pollution testers to fend off lawsuits and to be able to claim they have erected a "healthy" building.

mental Protection Agency, to which everybody is looking for a decision on just how dangerous the ash is, has only just woken up to its task, and has appointed a task force; expect no lead from that quarter for a while.) So Philadelphia has been hawking 28,000 tons of its ash around the Caribbean for the past year and a half. One of the two barges that carries the ash, the *Khian Sea*, has returned to base, having got rid of only a quarter of its cargo on Haiti, before the authorities there sent it away. The other, the *Bark*, is still at sea. The message has not been lost on incineration's foes, in Boston and elsewhere.

The answer, say these foes, is less rubbish and more recycling. Americans, they say, are too addicted to disposal and too idle to reduce the amount of rubbish they produce (they generate at least twice as much waste per head as Japanese and Europeans). Waste will have to be sorted to retrieve the paper, glass and aluminium before it is thrown away. One way to cut the amount generated would be to charge people in proportion to the amount they throw out. It has been suggested that full rubbish bags should carry stamps, like postage

stamps on letters.

The Japanese recycle more than half their waste paper. The Germans recycle nearly 40% of their glass. Both countries retrieve a third of their aluminium cans. The Americans retrieve only 28% of their aluminium, 27% of their paper and 10% of their glass. (The British are almost as wasteful as the Americans.) The amount of aluminium saved from the grave in the ten

largest OECD economies itself saves the need for five large power plants, which would otherwise be needed to make extra aluminium. Yet Americans can be induced to recycle. In parts of California and New Jersey, up to a quarter of the waste is recycled already, encouraged by laws that require the separation of newspaper, glass and aluminium cans. A similar law, to come into full force in 1992, was passed in New York last month.

However, recycling makes little sense in a free market. The revenues from the sale of recycled material simply will not pay the cost of collecting the metal, glass and paper saved. A subsidy is needed. Such a subsidy can still be a net gain to the taxpayer, if it works out cheaper than would the cost of disposing of the recycled rubbish by the old means. It costs altogether \$40-60 a ton to bury the stuff, and \$70-120 a ton to burn it. That makes recycled rubbish worth at least \$40 a ton in public subsidies to the buyers of recycled material.

Even with subsidies, many believe that recycling would quickly glut its markets or force the producers of fresh glass, paper and aluminium out of business. In some places, including



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EC4

AMERICAN SURVEY

Washington, DC, the bottle industry has successfully fought off attempts to pass recycling laws, arguing that they would force old ladies to drag huge burdens to bottle dumps. Even if the environmentalists achieved their goal of recycling more than half of America's waste, the problem of disposing of the

other half would not go away. The economical Japanese still burn a third of their rubbish.

The only hope of an easy way out is a new technology. In Pompano Beach, Florida, a plant will soon open that will turn rubbish into compost. About 100 small com-

posting plants are already at work in France, producing 800,000 tons a year. The idea is to shred, sterilise and seed the waste with bacteria, which then ferment it into a rich, clean compost that is superior to average soil.

The little research school that could

PASADENA

GREAT treasures sometimes come in small packages. The California Institute of Technology may well qualify as the crown jewel of America's research institutes. The university in Pasadena, ten miles east of Los Angeles, with just 850 undergraduates and about 1,000 graduate students, is tiny by American standards, yet it claims 21 Nobel prize-winners among its faculty and former students.

Caltech, as it is known, is also the home of some of the great discoveries in the history of science. It was there that Thomas Hunt Morgan fixed the role of genes in heredity and Linus Pauling discovered what holds molecules together. The institute also has an enviable reputation in physics, astronomy, geology and biology: despite its name, its strength is pure science rather than applied technology. Its endowment of \$400m makes it much richer than large institutions such as Ohio State University, which has 54,000 students and a \$225m endowment. Yet Caltech is only a fifth the size of its east-coast rival, the Massachusetts Institute of Technology, and not nearly as well known.

All its achievements, however, are not enough for Mr Thomas Everhart, who became the university's new president last September. A former chancellor of the University of Illinois, Mr Everhart wants Caltech to be the standard-bearer for excellence in scientific research of all kinds. He plans to strengthen the university even more by filling teaching posts only with scholars who are both world-class and better than their predecessors. He also wants America's most promising high-school scientists to come to Caltech.

Mr Everhart comes to the job with his own high reputation in physics. As a doctoral student at Cambridge University in England during the 1950s, he was one of the first collaborators with Sir Charles Oatley, the father of scanning electron microscopy.

Caltech churns out future prize-winners because it can attract brilliant students. Two-thirds of its undergraduates have achieved maximum scores of 800 on the maths part of the national college entrance exams. Two of every ten students

were class valedictorians (the brightest in their class at school). The school performs better than any other in America in the proportion of undergraduates (about 39%) who go on to earn doctoral degrees in the sciences. Even so, many do not. Caltech is so demanding that a quarter of its undergraduates drop out to take their degrees elsewhere. And a third of those who do graduate from Caltech take more than four years to get through.

An unusual morality pervades student life. Students enforce an "honour code" designed, among other things, to stop cheating in exams. Those living in dormitories on campus rarely lock their doors.



No little old lady in Pasadena

Some students are given keys to campus buildings so that they can study at odd hours of the night. Caltech bristles, however, at the suggestion that it specialises in turning out priggish nerds, interested only in science. All students have to take courses in the humanities and social sciences to round them out while they ponder the theories of Newton and Einstein. About 80% take part in extracurricular activities.

The students could be forgiven for being overawed by their teachers. The proportion of the faculty elected to the National Academy of Science and the Na-

tional Academy of Engineering is higher at Caltech than from any other university. Twenty-one ex-students and faculty members have received the National Medal of Science for contributions to science and engineering. And Caltech staff must be as committed to teaching as to research.

Little emphasis is placed on applying research commercially. Some professors moonlight as consultants, but they are not encouraged to do so, as are their counterparts at MIT and Stanford. So Caltech has not spawned high-tech companies in the way that MIT helped to spawn them along Boston's Route 128 and Stanford helped to spawn them in Silicon Valley. It remains an ivory tower of pure research.

Caltech began as the Throop Polytechnic Institute in 1891. It was founded by Amos Throop, a Universalist lay minister, who endowed it with \$200,000. It became known as the California Institute of Technology in 1920. It soon attracted Robert Millikan (a University of Chicago physicist and the man who first measured the charge of an electron), George Ellery Hale (an astrophysicist who built the Mount Wilson and Palomar Observatories) and Arthur Moyes, a chemist who had been acting president of MIT. Millikan put Caltech on the map when he won the Nobel prize for physics in 1923, a first for an American. That drew scientists such as Robert Oppenheimer, the future head of the Manhattan Project. In 1931 Albert Einstein came to Caltech, ushering in an era of prominence for the institute. In the 1950s and 1960s, much of the work of cracking the genetic code was done at Caltech.

Caltech's influence on the world today is perhaps felt most in astronomy. The university's tradition in this field was started by Theodor von Karman, who developed some of the principles of jet flight. Caltech now manages NASA's Jet Propulsion Laboratory, and its scientists have contributed to the design of America's unmanned space vehicles. The university also operates the Palomar Observatory, which has one of the largest telescopes in the world. To stake a claim for world prominence in astronomy, Caltech is working with the University of California at Berkeley to build the world's largest optical telescope, four times more powerful than the one at Palomar. Despite its small size, Caltech is still thinking big.

INTERNATIONAL

Meet Mikhail Gorbachev's pariah diplomacy

NOW here's a thing. The British foreign secretary, Sir Geoffrey Howe, gives a speech in the middle of May explaining Britain's opposition to economic sanctions against South Africa. Too often, he says, the South Africa portrayed overseas is "a caricature, not a living image of a multi-faceted, dynamic, extremely complex and confused reality." Sir Geoffrey's own words? Not at all: he is quoting, with approval, the views of Mr Boris Asoyan, the head of the Soviet diplomatic mission in Lesotho, a landlocked little country surrounded by South Africa.

It seems odd that a British foreign secretary should applaud Russian attitudes to South Africa. But the Soviet view of South Africa, like its view of Israel, is changing. Brezhnev's Russia saw the close relations between the West and these two countries as an opportunity. Through unflinching hostility towards the Israelis and South Africans, he hoped to add to Russia's stock of friendships in Africa and the Middle East. The Russia of Mr Mikhail Gorbachev now looks as disenchanted with this policy as it does with so many other aspects of its Brezhnev inheritance.

Russia's new approach appears to art from the following rather different proposition. Like it or not, Israel and South Africa happen to be the strongest powers in their respective corners of the world. The radical alliances with which Russia hoped to surround them have, by contrast, turned out to be frail creatures. Syria and South Yemen are Russia's only loyal allies in the Middle East. Angola and Mozambique, trapped in ruinous civil wars, have begun to turn away from Marxist policies and are now desperate for an accommodation with their powerful South African neighbour. A superpower with neither representation nor influence in Pretoria or Jerusalem has little to offer beleaguered Arabs and Africans.

Over the past two years the Soviet Union has been broadening its contacts with Israel. The Russians are not yet ready to renew the diplomatic relations they broke off during the six-day war of 1967, but a So-

viet consular delegation has been in Israel since last July. The Russians dismiss speculation that this is a first step towards the resumption of diplomatic relations: the delegation, they say, is just looking after Russian property in Israel. Still, it keeps putting off its return to Moscow. The number of exit visas granted to Soviet Jews has grown and most of the prominent refuseniks have been allowed to emigrate to Israel. In January the



Russians agreed to receive an Israeli consular delegation in Moscow. The visit is expected to take place soon after this week's Soviet-American summit.

The Russians have no objection to Israel in itself—provided it is an Israel inside smaller borders. They do have a quarrel with apartheid. But they have long kept up contact with the South African firms that control the world's diamond market and dominate sales of new gold. Now they have started low-level contacts with South Africa's ruling whites. Those ambassadorial views about the "complexity" of the South

African predicament are a good example. They were contained in a lecture which Mr Asoyan gave in Lesotho to a large group of visiting white Afrikaners from Johannesburg's Rand Afrikaans University. Unusually, the initiative for the meeting came from the Soviet embassy.

Where diplomatic contacts would be too sensitive, the Russians encourage academic contacts in their place. Last year Mr Philip Nel, director of the Institute for Soviet Studies at South Africa's University of Stellenbosch, was allowed to visit Moscow and to meet Soviet officials and academics. Sovietologists in South Africa detect a change in recent Soviet writing about their country, in Russian as well as English. It is in general a little less hostile to South Africa and a little more realistic about white staying-power. In 1986, for example, a member of the Soviet Union's Africa Institute, Mr Gleb Starushenko, mooted the idea of "comprehensive guarantees for the white population" and special constitutional arrangements calculated to allay white fears.

In the case of Israel, too, Russians are being encouraged to see the other side's point of view. One tactic is the use of readers' letters to newspapers. One letter published in *New Times* suggested that the war of 1967 might never have taken place if the Arabs had recognised Israel. Another correspondent quickly put things right, but the idea that the Arab-Israeli dispute might be another of those "multi-faceted" realities had at least been planted in readers' minds. Syria's President Hafez Assad and Mr Yasser Arafat of the Palestine Liberation Organisation have both been told, during recent visits to Moscow, that the absence of Soviet relations with Israel is an anomaly.

The Russians are enduring believers in cultural diplomacy. In recent years Soviet artistic troupes have played to packed audiences in Israel; and Radio Moscow has for more than a year been beaming an Afrikaans-language programme to South Africa. A group of South African journalists will soon be visiting the Soviet Union. Soviet four-wheel-drive vehicles, Russian hunting guns and Russian raspberry jam have recently gone on sale in South Africa. The South African foreign ministry has noticed the change in Moscow; it reciprocated recently by setting up its first-ever Soviet desk.

Raspberry-jam diplomacy has its limits. On the big issues, Russian policies have

INTERNATIONAL

changed a little less than appearances suggest. The Soviet Union is still demanding a bigger role for itself as the price for attending an Arab-Israeli peace conference. There is no hint of the Russians abandoning their support for the guerrillas of the African National Congress or of the PLO. They are still being fairly tough with the Americans in talks over Angola. But the Russians are at least holding out to both Israel and South Africa a tantalising possibility of what the Americans once called "constructive engagement". In the eyes of lonely countries, that is a seductive enough change in itself.

Israel

Pressing charges

FROM OUR ISRAEL CORRESPONDENT

FEW Israelis noticed when *Derekh Hanitzotz* ("Way of the Spark"), a small left-wing newspaper published by a fringe Jewish-Arab Trotskyist organisation, was quietly closed down by the authorities in February. Those who did were worried. A close eye has long been kept on the Palestinian press in the occupied territories; since the Palestinian uprising broke out last December the watch has grown fiercer. But for an Israeli newspaper such treatment was unprecedented.

In the past month all six members of *Derekh Hanitzotz's* editorial staff—five Jews and one Arab—have been arrested. After weeks of rumours and deliberate leaks, the authorities released one of the Israelis and charged the other four with membership of the illegal Democratic Front for the Liberation of Palestine. This small but radical part of the Palestine Liberation Organisation believes in dialogue with Israeli "progressive forces" as well as violent attacks against Israel. Charges have not yet been brought against the newspaper's Arab journalist.

The *Derekh Hanitzotz* affair shows all the signs of becoming another of Israel's celebrated security cases. The journalists are middle-class radicals dedicated to the cause of an Israeli-Palestinian peace, which they see as a necessary prelude to revolution. They are politically unimportant. But closing down newspapers does not square well with Israel's claim to be the only democracy in the Middle East. The Shin Bet security service, which is in charge of the case, will be asked to show that its secret evidence is credible and has not been obtained by illegal means. The defendants were denied access to their lawyer for longer than is normally permitted. They claim to have been told that an Arab prisoner would be tortured if they did not confess.

Derekh Hanitzotz has not been the only Israeli newspaper to suffer during the recent period of unrest. In March the Arabic-lan-

The don't-you-be-so-cheeky act

WHEN it comes to naming laws, the South Africans have a gift for finding *le mot injuste*. The "Extension of University Education Act" was a notorious example: it barred black students from white universities and confined them to a handful of tribal colleges with precious little money. Now meet the "Promotion of Orderly Politics Bill". If this bill became law it would stop organisations and individuals whose activities are deemed "political" from receiving money from abroad.

What, in South Africa, is unpolitical? On one estimate, at least 80 anti-apartheid groups, which between them receive about \$60m from abroad, would be cut off. They range from legal-aid groups to church organisations which subsist on the help they get from sister congregations abroad. But the language in the bill is hopelessly, and probably deliberately, vague. Like outspoken newspapers and trade unions, none of the organisations will be sure if the boot is coming until they feel it land.

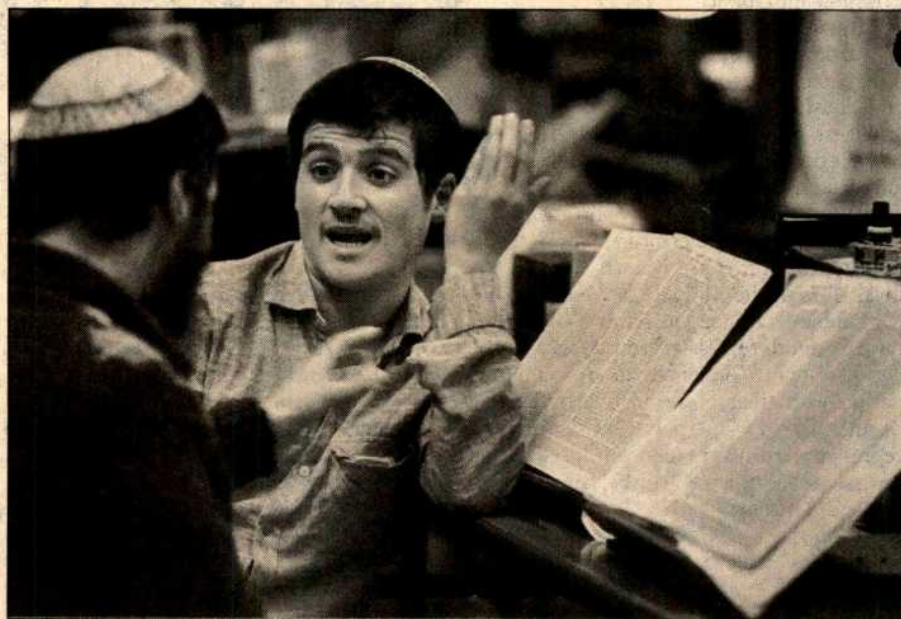
Many foreign governments which do not support economic sanctions against South Africa show their disapproval of

apartheid by giving money to black organisations inside South Africa. If donations are blocked, the pressure for more sanctions will grow. The American Congress, which sent \$22m last year to black groups, is considering a new batch of sanctions much tougher than those it imposed in October 1986. The Foreign Affairs Committee of the House of Representatives wants nearly all trade and investment in South Africa banned by the end of the year. The Senate and the president will cool the House's ardour; but some new sanctions are probable.

The chief of the aid-not-sanctions group is Britain. It plans to give £21m in direct aid over the five years from 1987, mostly for black scholarships; and it contributes about £3m a year to the European Community's aid fund. On May 23rd a group of South African church notables began a tour of European capitals by meeting Britain's foreign secretary in London. They urged louder protest and a tightening of sanctions. Their pleading is probably in vain: Britain deplores the threatened legislation, but expects that the scholarships it pays for will escape unscathed.

guage *Al-Ittihad*, the Communist party daily, was closed down for a week before the annual "Land Day" protests by Arab citizens of Israel. Liberal Israelis have been saying for years that the effects of their country's occupation of the territories captured in 1967 would eventually spill across the pre-1967 border into Israel proper.

What is happening inside Israel is still modest compared to what has been happening to the press and pressmen in the West Bank and Gaza Strip. Newspapers there are openly partisan. Despite the severe restrictions of military censorship they have made clear their support of the Palestinian cause. At least 33 Arab journalists have been ar-



All the news that's fit to print?

rested or detained without trial since the uprising began. Some are no more than tipsters whose ability to supply fast and accurate information from remote areas under army curfew has made them invaluable to both foreign and Israeli journalists.

The Palestine Press Services of east Jerusalem—theoretically protected by the Israeli law that governs the city—have been closed down. So has *Al-Awda*, a weekly magazine published in Arabic and English. Three of the four Arabic dailies published in the city have been regularly banned from the West Bank and Gaza; only the pro-Jordanian *An-Nahar* has been unaffected.

Israeli officials have been arguing recently that the uprising is waning as it approaches the end of its sixth month. But, as West Bank kindergartens and primary schools opened after a 20-week closure, the respected Hebrew daily *Haaretz* reported that a school in Nablus had been badly damaged by the soldiers who had been using it as a base. The army announced that it was investigating both that incident and others. The pen may not be mightier than the baton, but even under military occupation it has its part to play.

Guatemala

Five years, please

THE failed coup in Guatemala on May 11th may have been the latest result of the collapse of President Reagan's Central America policy. Guatemala's President Vinicio Cerezo has charged eight civilians with sedition and closed a television station which broadcast a discussion apparently sympathetic to the plotters. His loyal defence minister, General Hector Gramajo, has ordered the arrest of five colonels and a major. The general's support should keep Mr Cerezo, whose election in January 1986 ended nearly 20 years of military rule, securely in power for the rest of his five-year term.

The would-be coupsters were right-wingers whose distrust of the president may run wider than their own little circle. After taking office, Mr Cerezo endeared himself to the hard men in his army by leaving them to fight the war against the country's left-wing guerrillas as brutally as they chose. Since last September, however, his government has moved leftwards, holding talks with the guerrillas, proposing higher taxes for the rich and signing a price-and-wage-control pact with the trade unions.

The suspicions of the right were heightened by Mr Cerezo's foreign policy. He had moved slightly closer to his Mexican neighbours, whom rightists suspect of supporting Guatemala's rebels. The Mexican airline office in Guatemala City was bombed in pre-



Cerezo's the one on the left, now

sumed retaliation. When he allowed the Soviet and Cuban news agencies to open offices in the capital, the Soviet one was the target of a bomb. He obliged Nicaragua's Sandinist government by rescheduling its \$211m debt to Guatemala over 15 years. His wife went to a health conference in Cuba. The attempted coup may clip his wings. He has already postponed a planned meeting with the rebels, and the new tax proposals may be quietly forgotten.

The coup attempt has worried Mexico's President Miguel de la Madrid, who rolled out the red carpet for Mr Cerezo's visit earlier this year. Mexico's government likes to voice left-wing sentiments, and disliked the generals who used to run its southern neighbour. Guatemalan soldiers tended to stray over the frontier in pursuit of guerrillas, and some 40,000 Guatemalan Indians sought refuge inside Mexico. By backing Guatemala's new democracy, the Mexicans hoped to persuade some of these refugees to make their way back to their homes.

Mexicans tend to disdain Mr Cerezo, as they do most people to their south. Their diplomats reckon that his refusal to renew meetings with his rebels will help to keep the 26-year-old civil war going—and to keep the refugees in Mexico. So, they say, will Mr Cerezo's failure to tackle land reform. He eagerly insists that his only political ambition is to survive. That, say the Mexicans, may in itself make survival difficult, if Guatemala's peasant and labour leaders decide there is nothing in democracy for them.

The Mexicans grumble, but are not about to offer Mr Cerezo advice. Guatemalan sensitivities towards Mexico mirror Mexico's feelings about the United States. Guatemala dislikes providing Mexico with

cheap illegal labour; it believes Mexico swallowed nearly half its original territory; and it still feels that Mexico threatens its sovereignty. Mexican left-wingers spy Uncle Sam's nefarious hand everywhere; Guatemalan right-wingers suspect Mexico of meddling on behalf of the Socialist International. Offers of support from Mexico would make matters worse for Mr Cerezo.

Space

GlasMarstroika

BRIEFLY during 1975, the heyday of détente, Russian cosmonauts and American astronauts orbited the world in celestial harmony, their Apollo and Soyuz spacecraft docked snugly together. Mr Gorbachev, it seems, is feeling nostalgic. At this week's superpower summit in Moscow, he would like to talk to President Reagan about Mars.

The Russians have made no secret of their ambition to send a man to Mars, an undertaking that would dwarf all previous human exploits in space and might cost \$100 billion or more. The Americans are unlikely to hop aboard. They have found it hard enough to implement their own plan to co-operate with Japan, Canada and Western Europe on a far less ambitious plan to put a space station in orbit around the earth. Mr Gorbachev's previous offers of a joint project have been brushed off in Washington as part of Russia's propaganda onslaught on America's star-wars plans.

This time, though, Mr Gorbachev may have something serious in mind. One possibility could entail an unmanned "rover" from America (or Russia) landing on Mars and pottering about a bit. Eventually it would reach a rendezvous point where a rocket from Russia (or America) would land, relieve it of various scientific samples, and bring them back to earth. The plan has obvious merits. The Soviet Union's unmanned space missions, unlike its manned flights, are run by a civilian agency. Both countries are already thinking about unmanned Mars missions, so it would divert neither of them far from present goals. And, unless the two independently manufactured machines had a tendency to gossip, there need be no fears about one side stealing the other's technological secrets.

Space officials from the two sides have been laying the groundwork for this sort of joint venture since April 1987, when the United States and the Soviet Union renewed a space co-operation agreement that had been in abeyance since 1982. But some American officials resent Mr Gorbachev having broached the issue so early in public. He has, they feel, made it look too much like a Russian initiative, too little like a partnership of equals—which the Americans have



Apollo meets Soyuz in 1975. That time, the American was on top

not really been since the *Challenger* shuttle blew up calamitously over Cape Canaveral in January 1986.

Since that disaster, no American space shuttle has flown. The space station planned by the West will not go into orbit for at least six years, if at all: the plans for it have shrivelled in scope almost as steadily as they have increased in price. The Russians, on the other hand, already have a small space station, *Mir*, permanently in orbit. They may launch a shuttle of their own before America gets its fleet back aloft. In July two Rus-

sian probes will head towards Mars and its moons, the first of three missions to Mars planned for the next decade. Other Russian targets are Jupiter, Saturn and its moon Titan, comets and asteroids, and even the outer fringes of the sun.

Most Americans console themselves with the wishful thought that the Russian lead is temporary. The Russians have never displayed the technological virtuosity the Americans achieved in the 1970s with their Viking Mars landings and the Voyager missions to Jupiter and Saturn. Still, scientists

from both sides could benefit from more co-operation. Already, the Americans have agreed in principle to put a Russian radio on their planned Mars Observer satellite, which will help the Russians keep track of balloons they want to put into the Martian atmosphere. Planets may not influence summits quite as much as President and Mrs Reagan are reported to believe. This summit could still influence what earthlings know about planets.

Falklands

Transformation

A REPORT that an economy has achieved a 210% growth in one year is likely to make people assume that some desert sheikhdom has struck oil. The transformation revealed on May 24th lay in, of a places, the Falklands. The annual report of the islands' development corporation showed an increase in GNP from £9.9m to £30.7m. On the same day Mr Harold Rowlands, the financial secretary, in his budget statement to the Falklands councillors in Port Stanley, was able to announce plans for new capital spending of about £8m.

This dramatic change of outlook for a community of only 2,000 people has been brought about by the creation of a 150-mile-wide fishing zone around the islands. Since February of last year, when the new fisheries regime was put into effect, revenue has been

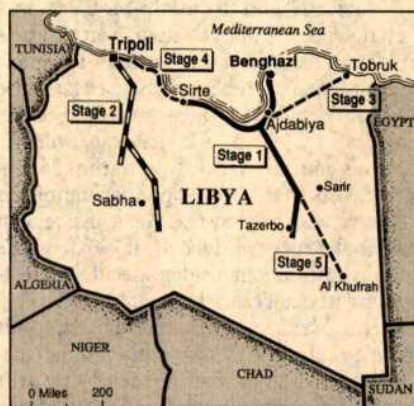
Libya's man-made pipe-dream

COLONEL Moammar Qaddafi is not a man to think small. His efforts to win international influence, by wooing and whacking his neighbours in bewildering succession (*vide* his embrace this week of the government of neighbouring Chad), have largely failed. But his domestic plans are no less grandiose. The Libyan leader wants to make his arid country self-sufficient in food by pumping water from under the Sahara desert to the more fertile coastal region. The "Great Man-Made River Project" is one of the world's most expensive engineering schemes.

The plan is to double Libya's water supply by laying 2,200 miles of massive pipeline (big enough, in parts, for a man to stand upright inside it on a friend's shoulders) in deeply corrosive soil. The cost will come to about \$25 billion, more than twice as much as the Anglo-French Channel tunnel. The decision to go ahead was taken just before Libya's oil revenues plunged from about \$21 billion in 1980 to an expected \$7 billion this year. Yet work

is going doggedly ahead. In February Libyan officials held a final bid-evaluation meeting with the four companies competing for contracts for the second of the project's five stages.

Water should begin to flow in late 1990, when the Tazerbo-Sirte leg of the first stage (see map) is complete; a line to Benghazi will open a year later. Together



they should produce 2m cubic metres of water a day. The finished scheme is expected to provide over 5m cubic metres, 80% of which is to be used for irrigation. That ought to expand Libya's irrigated land from 200,000 to 350,000 hectares.

Even then Libya might not be able to grow all its own food, although it could probably bring its agricultural trade into balance by concentrating on cash crops. Champions of the project point out that, without new sources of water, agricultural output would decline as the wells near the coast grow increasingly saline. Desalination plants would cost even more.

Is it sensible for a largely desert country to try to grow all its own food? Buying food abroad would be a lot cheaper. Self-sufficiency, though, matters to Colonel Qaddafi. Besides, the "man-made river" might help him to float back to the world stage. He has already offered to share the precious water with Egypt. By building a canal to Lake Nasser, the desert between the two countries "can be transformed into a paradise", Colonel Qaddafi exclaimed in March. Is even this scheme turning into an international stunt?

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INTERNATIONAL

pouring in from the fees paid by the hundreds of foreign ships fishing in the zone and from joint-venture operations. Apparently undeterred by angry noises from Argentina, shipowners from places as far apart as Poland and Taiwan have readily bought Falklands fishing licences.

By next year, the development corpora-

tion says, the islands will have six trawlers of their own at work, concentrating on catches of squid. Tourism, mainly in the shape of visits by cruise liners, is also starting to contribute to an economy which, for many years, had been almost entirely based on exports of the high-grade wool yielded by the islands' sheep. And, since the Falklands

have achieved a full employment almost any other country would envy, a consultant's report to be presented next month is expected to stress the need for more housing, to accommodate a small but steady influx of immigrants. The hard wind that blows across these islands is, at last, filling their sails.

Ice-picking in Antarctica

MINING in Antarctica has been the subject, throughout May, of an argument among representatives of 38 governments in New Zealand's capital, Wellington. The task set them was to complete by June 2nd a slow-motion negotiation that had begun in 1982, and to produce an international convention designed to regulate exploitation of the great frozen continent's mineral resources. Like previous talks in the series, the current ones have been held in strict secrecy. Outside the conference hall, however, there have been demonstrations by protesting environmentalists, voicing their suspicions that a "carve-up" is being plotted.

The negotiators in Wellington represent the parties to the 1959 Antarctic Treaty: Argentina, Australia, Britain, Chile, France, New Zealand and Norway, all of which had staked out Antarctic territorial claims (some overlapping: see map) before 1959; the United States, the Soviet Union, Japan, Belgium and South Africa, which were also original signatories of the treaty; and 25 subsequent adherents. The third group includes Brazil, China, West Germany and India, which are among the states that have qualified for veto-wielding rank as "consultative parties" by sending expeditions to Antarctica and establishing research bases there.

The treaty's first purpose was to stave off territorial conflicts. The existing claims were (appropriately) "frozen". It was agreed that Antarctica should be used only for peaceful purposes; scientific stations could be set up in any part of it, but each treaty party must let the others inspect its stations to make sure it was observing the rules. By and large, this system has worked. Yet it is showing signs of strain. The region's commercial potential is gradually becoming apparent, and conflicts of interest are stirring.

To prevent these shattering the treaty, its signatories are trying to devise means of sharing out Antarctica's spoils without awakening old nationalistic claims. At the same time, a group of non-signa-



Heard the one about the toothfish?

tory countries is demanding that the treaty should be scrapped and the administration of the continent handed over to the United Nations.

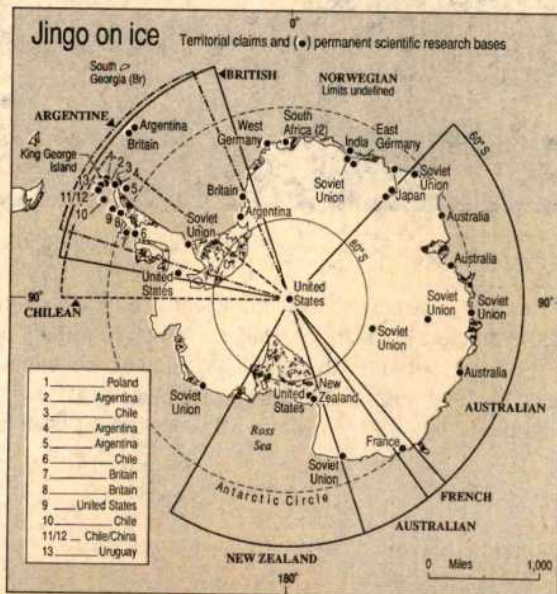
Environmentalists fear that man's greed for new resources will bring Antarctica's destruction. Look, they say, at what has happened to fish, the only Antarctic resource that is already being exploited. Since the late 1960s Patagonian toothfish and other species have been netted in

such quantities that one group of conservationists, Greenpeace, wants a ten-year ban on fishing for them. More may hang on the fate of the shrimp-like creatures called krill: they are full of protein, which makes them popular with Japanese and Russian fishermen as well as being the staple diet of larger sea-life, including the endangered whale.

In 1982 the treaty countries brought into force a convention on "conservation of marine living resources", under which quotas are allotted to countries that want to fish Antarctic waters (the environmentalists say the quotas are often ignored). Now a similar formula is likely to be applied to minerals. Firms that want to exploit them would have to obtain licences from an international commission.

The minerals convention will have to wait for ratification before it comes into force. That could take a decade. There is, however, no great hurry. Small finds of copper, uranium and platinum have been made, and larger ones of iron and coal; but there is no sign yet of anything that would make it worth trying to drill through the mile-thick ice that covers most of the continent. The Antarctic seas may be more hospitable. In the 1970s traces of gas were discovered under the Ross Sea, and America offered a much-quoted guess that there might be 45 billion barrels of oil on Antarctica's continental shelf. Geologists point out that for 40m years freezing temperatures have deprived the Antarctic continental shelf of the river sediments in which oil and gas might collect.

Should drilling for offshore oil ever be permitted? Environmentalists fear that, in Antarctica's stormy seas, it would be hard to prevent oil leaks. They also say that teams of prospectors would cause overcrowding. Antarctica is twice the size of Australia, but only its fringes could take the extra settlers. Already the most accessible spot, King George Island in the South Shetlands, is too full of research bases for the liking of the penguins, seals and albatrosses. The decent thing, the conservationists say, would be to declare the continent a world park.



EUROPE



Grosz starts farther down the slippery slope than Kadar did

Round two in Hungary

FROM OUR CENTRAL EUROPE CORRESPONDENT

UNTIL last Sunday, about half of all Hungarians could remember no leader other than Mr Janos Kadar. Until a few years ago, a majority of them might even have voted for him in a free election. But the Kadar charm had worn thin; after 32 years, it was high time for a change. When the change came, at the end of a special conference of the Hungarian communist party on May 20th-22nd, it was stunning beyond all expectations. Not only was there a new party leader, Mr Karoly Grosz; there were also 35 new members on the 108-strong Central Committee and six new people in the 11-member Politburo. The Politburo now includes the party's two most outspoken radicals. Budapest taxi-drivers need no more convincing that there is something they are entitled to get excited about.

Mr Kadar's exit, in a farewell speech on May 22nd, was rambling and reluctant. It was an undignified end for a man who, after coming to power on the rubble of Hungary's failed revolution in 1956, had transformed his reputation from stooge to statesman. Mr

Grosz, like Mr Kadar in those early days, starts out with scant support within his party. He has grabbed the top job through a series of clever bargains.

The decisive moment was a stormy Politburo meeting on May 16th. Mr Kadar's friends put up a fight, but Mr Grosz had done a deal with key people in the Central Committee, which proved too much for the Kadar loyalists. In return for the leadership, Mr Grosz promoted two leading liberals to the Politburo. They are Mr Rezso Nyers, a senior member of the pre-communist-monopoly Social Democratic party and the architect of Hungary's 1968 economic reforms, and Mr Imre Pozsgay, the outspoken chairman of the communist-backed Patriotic People's Front. At a press conference last week Mr Pozsgay was asked what sort of democracy he wanted: "A democracy without adjectives", he replied. Mr Nyers said he reckoned Hungary will have to bow eventually to the multi-party system, "but not in my lifetime."

These are remarkable views for mem-

bers of a ruling communist party's top body. Mr Grosz's Politburo contains independent minds which he may find difficult to manage. Not that he lacks experience of knocking comrades into line. Now 57, he built his reputation as a tough administrator when he was party boss in Borsod county in the late 1970s and later chief of the Budapest party organisation. His stint as prime minister since June has shown that he has the toughness to push through unpopular economic measures, including tax reforms. But many Hungarians suspect his firmness will slide back to authoritarianism.

Mr Kadar could build a compromise after the failed revolution of 1956 because Hungarians expected little from him. The crushing of the rebellion, it seemed, had put an end to all hope of change. When Mr Kadar eventually began to open the country up, they were happily astonished. Unlike him, Mr Grosz has been catapulted to power by the growing pressure inside and outside the party for greater freedom. Having got to the top, his worry is how to contain the forces that put him there.

By promoting Mr Pozsgay and Mr Nyers, Mr Grosz presumably intends to strengthen his own power base. He can use the two men as a bridge to reform-minded groups outside the party. He may also reckon that they will be less bothersome now they are subject to the discipline of Politburo membership than they would be if they were free to criticise loudly from the wings. Still, it will be hard for Mr Grosz to silence the calls for far-reaching reform.

The economy requires courageous handling (see box on next page). The things that need doing to rescue it include a new squeeze on consumer spending, and a cut in subsidies on housing and heavy industry. Such measures will increase the already loud grumbling from over-worked Hungarians. To keep protesters off the streets Mr Grosz may have to balance austerity with a good-sized extra dose of political freedom.

A list of things that might move Hungary in this direction has already been drawn up. A new law of associations will be presented to parliament in September. This will permit the legal establishment of independent political groups, a number of which now operate more or less openly but are officially non-existent. It is planned to adjust the constitution to make it quite clear that the party, like other Hungarians, has to live within the law. This will strengthen civil liberties but it could sharply diminish the party's authority.

Mr Grosz has to decide exactly what he means by "socialist pluralism"—an attrac-

tive phrase used throughout last week's conference which, so far, remains undefined. He will therefore have to spell out what is involved in the idea of "separating the party from the state". If this includes letting non-communist groups into parliament, and allowing parliament the right to draw up legislation without waiting for the communist party's draft, the party could be approaching a challenge to its "leading role", the formula by which all ruling communists keep their grip on power. Once non-communists can operate freely, the logical next demand is an election in which people can freely choose between them and the communists.

Mr Grosz will want to make sure that his party can withstand any such challenge. But it will do so only if he can control the push for change. That is why Mr Grosz is in charge, and why Mr Mikhail Gorbachev sent him a warm message of congratulation on the night of his appointment. Mr Grosz's job is to construct a new Hungarian compromise. He may have to pay a higher political price for social peace than the discarded Mr Kadar ever did.

France

Mountain comes to Mitterrand

FROM OUR PARIS CORRESPONDENT



"It's not healthy for only one party to govern," President Mitterrand remarked on his annual pilgrimage to the rocky peak of Solitré in the Morvan. He was thinking of another sort of mountain—a large Socialist majority in the National Assembly—and probably wishing it were smaller than it looks like being. In the two-round parliamentary election on June 5th and 12th, if the opinion polls are right, the Socialists could win 350 or more of the 577 seats in the assembly. In his gnomic way, Mr Mitterrand was warning his party not to believe that France is swinging left.

So far as France's election system allows, voters recently seem to have been asking for middle-of-the-road government. They are

for the most part quick to punish politicians, left or right, who stray far from the centre. That they may now be about to set off a Socialist landslide in parliament is not as contradictory as it sounds.

First, the Socialists of 1988 are a lot more centre-minded than they were in 1981. In addition, the split and collapse of France's mainstream right offers voters a weak alternative. Third, as in Britain, first-past-the-post voting may translate a small percentage swing into a sweep of seats. One poll even suggests the Socialists could win 410 seats with 44% of the vote against 40% for the two main conservative parties. Voters who would be content with a modest working majority for the Socialists have little scope for fine-tuning the result.

On the evening of June 12th, assuming the Socialists have won a landslide, some conservatives are bound to say that a divided France has been plunged back into party war. Yet Mr Mitterrand is probably sincere in his warnings to the Socialists not to treat the result as giving them a temporary party dictatorship. If he can, he wants eventually to prise away some centre-right

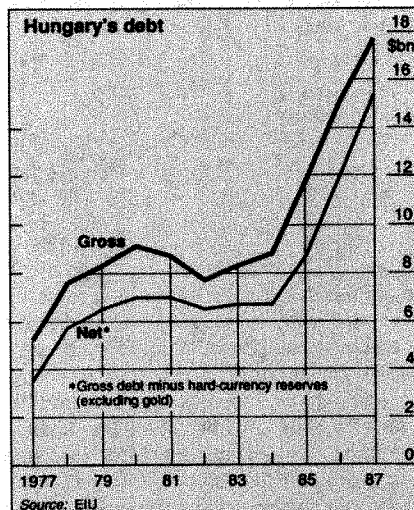
Danube blues

FROM OUR SPECIAL CORRESPONDENT IN BUDAPEST

EVER since the New Economic Mechanism was introduced in 1968, economic reform in Hungary has suffered from a chasm between rhetoric and reality. Because the communist party has refused to let go of any power, each successive attempt at reform has fallen victim to meddling bureaucrats who turn fine projects into feeble half-measures. The result is an economy that obeys neither market nor plan. Hungary today is a confusion of giant state monopolies, struggling private enterprises and constantly changing rules.

In the past three years Hungary's gross hard-currency debt has doubled to \$17.7 billion. Debt servicing will gobble about 40% of hard-currency earnings this year, and this proportion is destined to grow. To begin to repay the debt, Hungary must export more to the West. But Hungarian managers have little incentive to produce the goods westerners want to buy. Despite the original intentions of the 1968 blueprint, the politicians have been reluctant to expose domestic producers to foreign competition. Misguided investment has left infrastructure underdeveloped and factories undermodernised. Massive new investment is needed if Hungary is to become competitive in western markets.

It was only in September 1987, three months after Mr Karoly Grosz became prime minister, that the government ad-



mitted the mess the economy was in. At that time a "consolidation programme" of austerity and reform was introduced. The idea was to stabilise the economy through strict austerity, with a promise that market-oriented reforms would in the long run bring prosperity.

In 1988, as planned, real incomes have fallen, exports have increased and the trade balance has been righted. But exports have grown mainly in heavily subsidised industries, inflation is threatening to run out of control, new taxes have puzzled the book-keepers, and im-

port cuts have disrupted production. Those cuts have been achieved more through a reversion by the minister of trade, Mr Jozsef Marjai, to the bad habit of crossing goods off the import list than through IMF-favoured financial controls.

At last week's special party conference delegates came out clearly in favour of a radical approach. Reforms under discussion include a law on corporate association, to be presented to parliament in September. The proposals so far include the granting of equal rights to all economic units, private and state. Shareholding will be encouraged. Private enterprises and individuals will have the right to own stock and to form limited companies. This key law is to be accompanied by a new wage law, liberalisation of prices and reform of the budgetary process. The new party leadership will soon consider recommendations to open the domestic economy to foreign competition.

Will reality match rhetoric this time? Reformers see hope in the promotion of some true radicals to the Politburo. Opening Hungary to the West would mean factory closures, more unemployment and a trade deficit that could be financed only by another increase in foreign borrowing. But such an opening is Hungary's only hope. The opposite approach, import cuts, will reduce its ability to export westward, and so lead to more import cuts. This is the downward spiral from which Hungary must escape. It will now argue that it needs some help from the West to do so.

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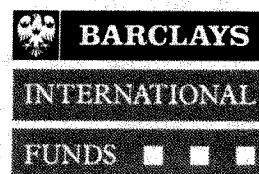
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politicians into a new, middle-of-the-road group that could work with the Socialists.

Despite the fuss that followed the formation of Mr Rocard's minority Socialist government, the clearer-headed centrists like this idea. No matter that the Socialist offer of uncontested seats for some 20 centre-right politicians was rebuffed. Neither side seriously expected it to be taken up, any more than they thought there was a serious chance of centre-right leaders joining a Socialist government, once Mr Mitterrand had been re-elected with 54% of the vote. Many of the centre-right politicians who follow Messrs Raymond Barre and Valéry Giscard d'Estaing are ready to drop the "right" bit of their party tag, but only after a decent interval.

Mr Daniel Hoeffel, a centre-right senator and president of the general council of the Bas-Rhin, the northern bit of Alsace, sums up well the problem he and his colleagues are facing: "Our elected officials pull right, our voters pull us left." In local and regional councils, the centre-right and Mr Jacques Chirac's neo-Gaullists are allies. But many centre-right voters dislike the populist, hard-right wing of neo-Gaullism. They suspect its members of softness towards the far-right National Front. These voters would prefer centre-right politicians to team up with the Socialists. Centre-left alliances could begin in the local elections next spring and autumn.

For the moment, the centre-right remains tied to the neo-Gaullists. The two groups are running joint candidates in 530 constituencies under the unfortunate label "Union de Rassemblement et du Centre". Its acronym, URC, sounds like "Beurk", French for "yuk", a rhyme the far-right lead-



Mountaineer—reluctant

Yes, the timing was curious

FROM OUR PARIS CORRESPONDENT

THE row continues over the operation to rescue French hostages in New Caledonia, in which 19 civilians and two French soldiers died. Somebody has leaked a confidential report by Captain Philippe Legorjus, the head of the anti-terrorist unit which led the raid on May 5th, three days before the run-off in France's presidential election. It implies that the action was taken under political pressure before a negotiated settlement had been fully attempted.

Captain Legorjus, now a major, also suggests that the military commander of the island, General Jacques Vidal, and Mr Bernard Pons, who was at the time minister for the overseas territories, had to be argued out of ordering junior officers to carry out "alarming" measures. According to Major Legorjus, these measures included precision-bombing or napalming the island grotto where 23 French gendarmes and soldiers were being held by Melanesian separatists.

Mr Pons, in a press conference on May 24th, denied that he had considered such steps. He said he had left the "technicalities" to the army and that he was, at least to begin with, more open to a negotiated settlement than appears from the Legorjus report. He attacked the leaking of a confidential report, presumably from the ministry of defence after the

outgoing conservative minister had handed over to his Socialist successor, Mr Jean-Pierre Chevènement.

Major Legorjus is a specialist in negotiating with kidnappers. He hints that General Vidal was for a military rescue from the start. The general's friends deny this. So reluctant was he to give up the chance of a negotiated release, they say, that his political masters thought at one point of recalling him.

The finger-pointing in Paris is not helping a six-man group sent by the new government to "establish a dialogue" in New Caledonia. It is a help for Socialist candidates in the parliamentary election. Fairly or not, the raid was widely taken in France to be part of a last-moment bid for votes by Mr Jacques Chirac, the conservative presidential candidate, who was then prime minister.

The affair was not entirely Mr Chirac's. Mr Mitterrand was involved, on the side of conciliation—at least to begin with. His suggestion that he and the prime minister jointly name a mediator, as the hostage-takers wanted, was met, it seems, with silence from the prime minister's office. Yet once a military rescue plan was decided on by the government, it had the president's blessing, provided casualties were kept light. Easier said than done.

er, Mr Jean-Marie Le Pen, was quick to seize on. He is threatening reprisals against the mainstream right if it honours its pledge to make no deals with his party.

Yet the National Front may not have much to trade. To get into the second round, a candidate's score must be at least 12.5%, not of the votes cast, but of registered voters. In the first round of the presidential election, the National Front got this in 141 constituencies. Abstentions, however, are high in parliamentary elections following presidential ones, which makes reaching the second round harder. Though the National Front usually does better on polling day than the forecasters predict, it could lose all but five or six of the 32 seats it won under the former system of proportional representation. To save themselves, the party's leaders, Mr Jean-Marie Le Pen, Mr Bruno Megret and Mr Pierre Stirbois, have all parachuted into Marseilles, where the far right is particularly strong.

On the far-left side of the National Assembly, the Communists will be lucky to keep ten of their 35 seats. Only their presidential candidate, Mr André Lajoie, and four of his colleagues seem reasonably safe.

In the old red belt around Paris, eight of their nine deputies, including Mr Georges Marchais, the party leader, may be in trouble if they are not helped by Socialist withdrawals in the second round. Crushed, and facing the loss of municipal patronage in next year's local elections, Mr Marchais still has some pride. He has rejected a condescending Socialist offer to leave a few seats open for the Communists.

A Socialist mountain, a battered right, and two protest movements virtually pushed out of parliament into the street: Mr Rocard and Mr Mitterrand may need help to keep their government at the centre.

Denmark and Norway

Fear of foreigners

FROM OUR NORDIC CORRESPONDENT

THE strength shown by Mr Jean-Marie Le Pen in the French presidential election has made people look around for other evidence of the growth of the far right in Europe. Some people have been glancing at



Pia, not quite right

Scandinavia, where the Progress parties in Denmark and Norway have been calling for less immigration and picking up a lot of votes. Neo-Nazis? No: just old-style liberals making illiberal complaints about dark-skinned foreigners.

In Denmark's election on May 10th its Progress party advanced from 4.8% of the votes to 9%. Mr Mogens Glistrup, the party's founder, said that perhaps half of its gains were attributable to its call for a tightly restrictive policy on immigration. But the party's present parliamentary leader, Mrs Pia Kjaersgaard, plays down that issue, attributing her party's success to its demand for tax cuts. Since the tax take had risen to 52% of GDP during the five years of Mr Poul Schlüter's centre-right coalition government, she may be right.

Next door Mr Carl Hagen leads the Norwegian Progress party, founded in 1972 within months of the birth of the Danish party. Mr Hagen's success has been even more spectacular than Mrs Kjaersgaard's. In



Carl, plus 23%

the 1985 Storting election his party got 3.1% of the votes; in last autumn's local elections it got about 12%, and it is now scoring 18-23% in the opinion polls.

The two parties have little in common with the extreme right elsewhere in Europe. But their attitude towards immigrants, and the occasional remark by Mr Glistrup (eg, "So long as there are high taxes and Muslims, we've got something to fight for"), gets them tagged as a variant of Le Penner. In other respects they are libertarian parties, whose economic policies fall in with Adam Smith. There is no taint of fascist ideas in their programmes or speeches. They are not anti-semitic, and "moral majority" attitudes do not figure in their appeal.

How important is the immigration issue for them? In Norway, an openly anti-immigrant party was recently formed by hardliners who regard Mr Hagen as too soft on the issue. But the Progress parties strike a

sympathetic chord with some voters by arguing that refugees from the Middle East and elsewhere are often "refugees of convenience" who cost the taxpayers a lot of money.

Mr Glistrup argues plausibly that the two Progress parties do best when voters' expectations have been disappointed by governments of the traditional right. His own party fought its way into Denmark's Folketing for the first time in 1973, getting almost 15% of the votes, after government by a centre-right coalition in 1968-71 had led to a record increase in taxes and public spending. The sequence has just been repeated. In Norway Mr Hagen shot up in the opinion polls after a speech in which he accused both the traditional non-socialist parties and the ruling Labour party of failing to keep their election promises. It may be significant that, although he mentioned immigration, it was almost in passing.

Job-creation

Locally does it

The United States created 28m extra jobs between 1970 and 1986, while the big West European countries created next to none. Why?

ONE simple reason is that American employers are keener to employ women and young people, because their minimum wage has declined and they can be almost as easily fired as hired. Perhaps, too, American culture is more enterprising, and Americans more mobile. But officials at the OECD reckon that Europeans should find much to imitate in specific American programmes to create new jobs—in particular, locally based partnerships like those that have revived parts of Baltimore, Chicago and Boston. For these boffins, the lessons for Europe are that:

- **Home-grown jobs** should be valued more than imported ones. When large old factories close in manufacturing cities, the first reaction is usually to offer subsidies to large new factories. This is what the Americans call a "buffalo hunt", and many cities are still trying it. But most have found that outside firms stay loyal to a new area only so long as the subsidy lasts. Nurturing a dynamic local workforce creates a better climate for business of all kinds than is sometimes found in communities used to relying on jobs provided by a single large employer.
- **Small and medium-sized firms** are therefore seen as vital to local employment growth. Small businesses often fail. They cannot quickly fill the gap left when a big firm shuts its doors. But large firms, still essential to full employment, are more likely to come to areas where small ones thrive. In America small firms have lately been directly responsible for an estimated 50-70%

of net employment growth.

● **Local partnerships** between the public and private sectors can stimulate enterprise. Several American city governments offer credit, training and new infrastructure to local people with business ideas, through enterprise agencies financed jointly with private companies. The choice is not between direct public investment in the economy and pure laissez-faire. A black woman with a good business idea but no access to credit; a redundant craftsman who wants to run a small workshop but lacks management skills; a trading company which needs better offices and communications to expand—all may need extra backing if they are to create jobs in depressed districts.

From Baltimore to Bilbao

The Europeans' first reaction to the decline in large manufacturing industries was to pour money into the worst-hit regions. The OECD has a unit to preach the idea of creating a new local economic base, with more self-help and fewer handouts. It recently ran a seminar in Bilbao, in northern Spain, to convert Basque mayors to its cause.

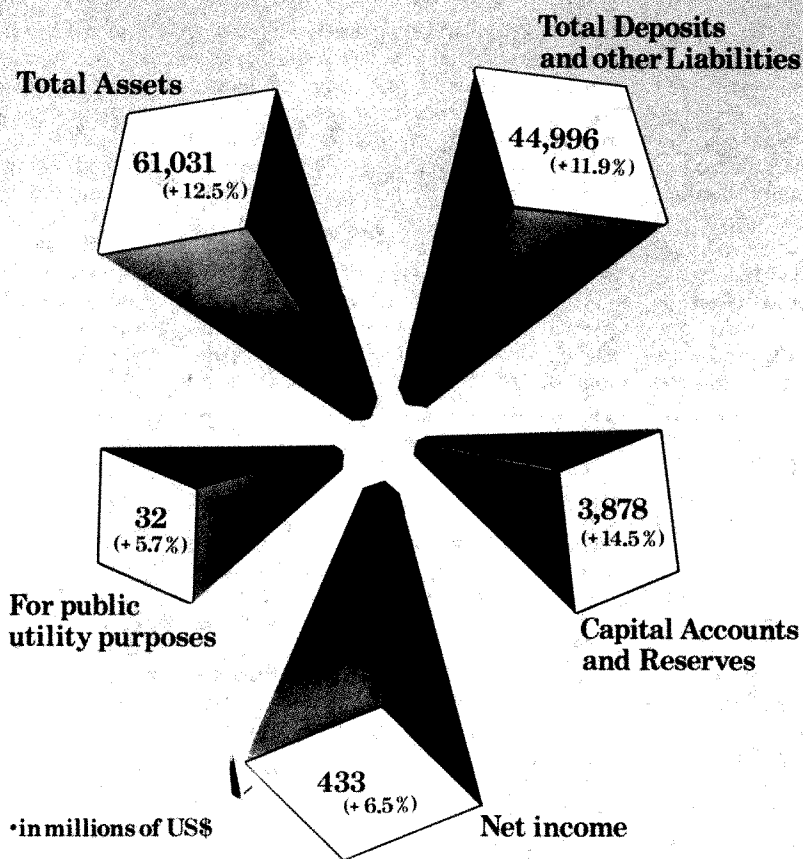
The Spanish Basque country lost 90,000 of its 360,000 industrial jobs between 1977 and 1983, while employment in service industries rose by only 10,000. The central government has poured billions of pesetas into a Basque "regeneration zone" which produced only 2,300 costly, mostly old-fashioned jobs.

The Basque mayors were told that in

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some parts of Europe, in different ways, Europeans are following the American road to local job-creation. The collapse of the ship-building industry in Sweden spurred employers and local authorities to wean workers off their reliance on big industry—gradually. The Kockums shipyard, closed in 1986, has been split into three parts, one building submarines, one making Saab cars and the third set aside for new companies.

The authorities planned new jobs before the yard closed, hoping to keep the most enterprising workers in the area rather than letting them drift off to greener pastures. Only 94 of the 2,049 employed at Kockums in 1986 had to be made redundant.

In Britain collapse has been more brutal. In industrial Lancashire 4,000 jobs were lost in a single week in 1982. Out of that shock was born one of the most successful of Britain's local enterprise agencies, Lancashire Enterprise Limited. Venture capitalist, industrial landlord, trainer, market-analyst and patent adviser, LEL is a one-stop shop for firms wanting to start or expand in the county. When a firm making pre-cast products in a remote rural area closed its factory to chase a development grant 30 miles away, the banks would not lend its workers money to revive the factory as a co-op. LEL loaned them £50,000; they broke even within a year, and thrive today though the relocated factory has had to close.

Kockums and the LEL are all-too-rare examples of European success. Local self-help in Europe is held back by:

- Weak local government in some countries. Europe's town halls are constantly being handed jobs to do but lack, they complain, the resources to do them with. In Spain, four different tiers of government spend

much of their energy blaming each other for not solving local problems. In Britain, the central government questions whether local councils should get involved in economic development, and has recently made it harder for them to invest directly.

- Centralised decision-making from offices in a capital city can obstruct the creation of local partnerships. Europe's business leaders are often slow to back local enterprise schemes. American firms have a long tradition of local philanthropy, which good city managers are quick to exploit. Most European countries—Britain being the glaring exception—are trying to devolve economic power from their capitals.

Local self-help is becoming fashionable throughout Europe, with politicians of both left and right. The left believes in "communities" rather than multinational companies, the right wants to encourage enterprise and self-reliance. In America there is less ideology about it, but a solid belief that social and economic goals are inseparable. A group of Frenchmen on a recent visit to Chicago was surprised by the "thoroughly entrepreneurial" approach to neighbourhood revitalisation there. Slowly, some European neighbourhoods are starting to benefit from the same spirit.

May in the EEC

East meets West

The EEC and Comecon, the Soviet block's trading organisation, reached an agreement to establish official relations after ten years of negotiations. The key to the deal is a compromise on West Berlin. This recognises West Berlin as part of the Community but still accepts the special position the victorious allies of 1945 gave to the city. The agreement opens the way for co-operation, as yet unspecified, between the two groups and for trade pacts between the Community and individual Comecon countries. The first of these is expected to be signed with Hungary before the end of the year.

Trade and industry

The Community has refused to make a commitment, sought by America, to phase out all its farm subsidies by the year 2000. It has also blocked, for the moment, an American request for an investigation by GATT into its subsidies to producers of soya. The United States says these hurt American exporters.

The commission, applying a little-used article of the Treaty of Rome, surprised EEC

governments by ordering them to end their monopolies (where these still exist) on the supply of telephone and telecommunication equipment to subscribers. Under Article 90 of the treaty, the commission can by-pass national governments when dealing with state monopolies. Governments have two months to appeal to the European Court of Justice if they think the commission exceeded its authority. None is likely to do so.

Court of Justice

The high cost of dying in many parts of

France may break EEC rules. The court ruled that if a large firm of undertakers, Pompes Funèbres Générales, used its exclusive right to burials in 2,800 graveyards in France to overcharge customers or stifle competition it could be guilty of abusing its dominant market position under Community law. The court had been asked for guidance by a French court in a case brought by a Mrs Corinne Bodson, who sought to open a cut-price funeral parlour at Charleville-Mézières in northern France.

Finance

Finance ministers reached broad agreement on a timetable for lifting the capital controls still imposed by some EEC countries. The deadline will be 1990, except for the poorest Community countries.

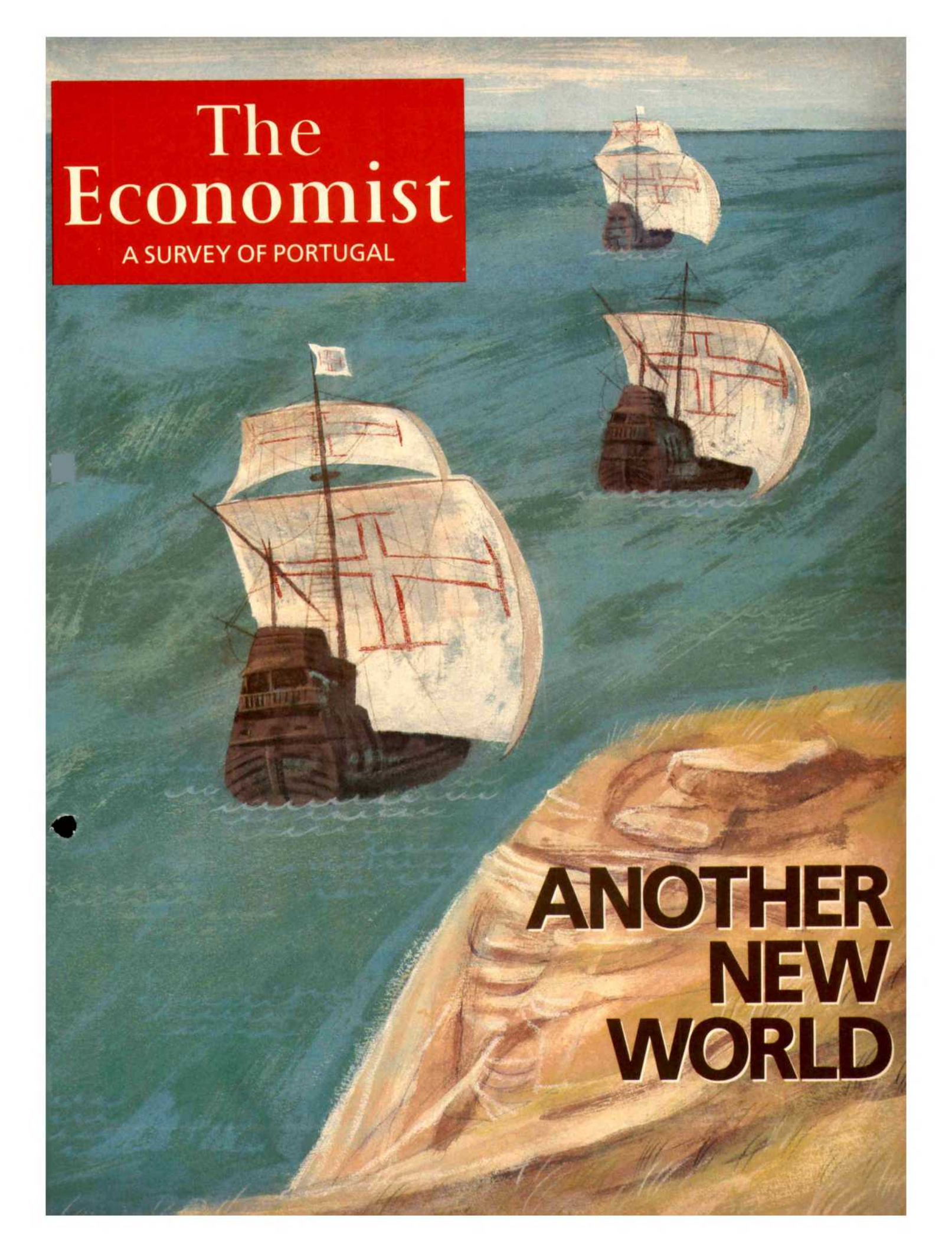
Presidency

Mr Martin Bangemann, the West German economics minister, made a bid for the presidency of the European Commission at the end of this year. But he spoiled his chances of ousting Mr Jacques Delors, who is seeking a second term, by saying he was also ready to settle for a vice-presidency. The Community's leaders will decide who gets the job at their summit in Hanover on June 27th-28th.



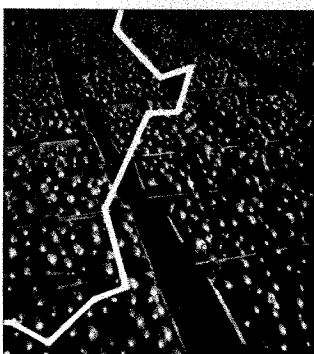
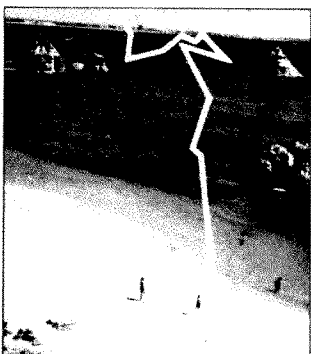
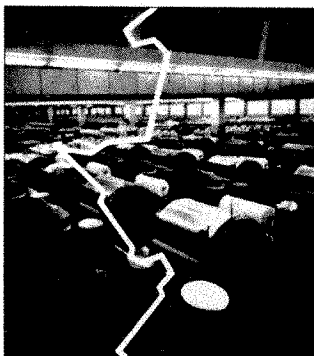
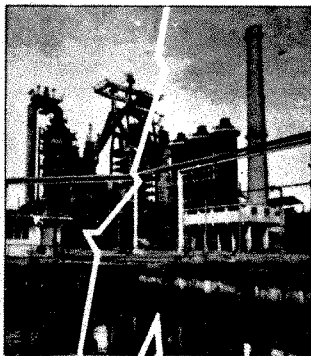
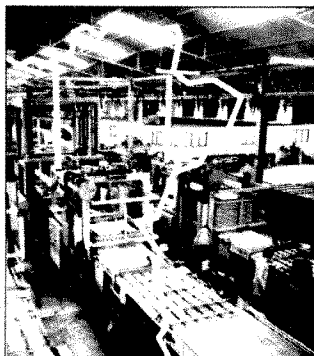
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PORTUGAL



The discovery of Europe

THE Portuguese have a rare and endearing ability to laugh at themselves, as long as others do not. An acquaintance there was asked whether *amanha* (the word for tomorrow) has the same procrastinating overtones as *mañana* does in Spanish. "Mañana conveys more urgency," came the reply.

That attitude is less apparent than it was to a visitor returning for the first time in 20 years. Much has changed since Antonio Salazar, then a sick dictator, was replaced by another supremo after 36 years in power. A revolution, the loss of the last European empire, a decade of domestic confusion, fallout from a world economy on a roller-coaster—have left their mark. So has a growing new confidence in Portugal and its future, born in the past two or three years. Superficial impressions are of a very different place.

Lisbon, a more beautiful San Francisco where tiled houses tumble down hills to the water and trams trundle up them, is perhaps a little dirtier. The Algarve in the usually sunny south is a sea of construction cranes. There are more brown faces after the absorption in the mid-1970s by 9m European Portuguese of some 700,000 *retornados* from the country's newly independent African colonies. Everyone in the civil service, business or politics also seems to teach at one of half a dozen new universities or new faculties at old ones.

Yet for a country which less than 15 years ago was gripped by a reasonably red revolution, there are fewer signs of redistributive change than one might expect. Of the 1.3m hectares of agricultural

estates in the southern and central regions of Alentejo and Ribatejo expropriated in 1975, fewer than half remain occupied. Many of the rich who after expropriation emigrated to South America or France are returning, usually not so rich but far from poor. Six years after the abolition of the last institutional vestige of rule by the military who made Portugal's revolution, there are no uniforms in the cabinet. The communist-dominated unions who called the political shots ten years ago have non-communist competition; together they seem now to have the power to disrupt but not to destroy.

Portugal appears to have found, for the first time and after 16 post-1974 governments, its democratic centre of gravity. Mr Anibal Cavaco Silva, a Social Democrat, received over half of the vote in July 1987, becoming the first prime minister since the revolution to win an absolute majority and a likely four-year term in office. His life-expectancy is enhanced by so-far friendly *coabitacao* with the Socialist president, Mr Mario Soares, whose avuncular charm complements the prime minister's sometimes abrasively confident sense of direction.

At the same time, Portugal's economy has begun to flourish. After a usefully tough IMF adjustment programme in 1983-85, and helped by cheap dollars and oil and by money from the EEC, Portugal has grown faster than all other European Community members during the past two years. It is set to do so again in 1988, albeit at a slower rate of growth, and the outlook at least until the 1990s is good. Inflation has been reduced to 8-9%, while unemploy-

For more than a decade, Portugal has barely survived change. Now it must change to survive, writes Merrill Stevenson

1987 average:

Esc100 = \$0.7098

Esc100 = £0.433

Esc100 = Ptas 87.6

End April 1988

Esc100 = \$0.733

Esc100 = £0.388

Esc100 = Ptas 81.1



ment is officially measured at 6.6%. Foreign investment is pouring in, and the Portuguese are themselves investing more too.

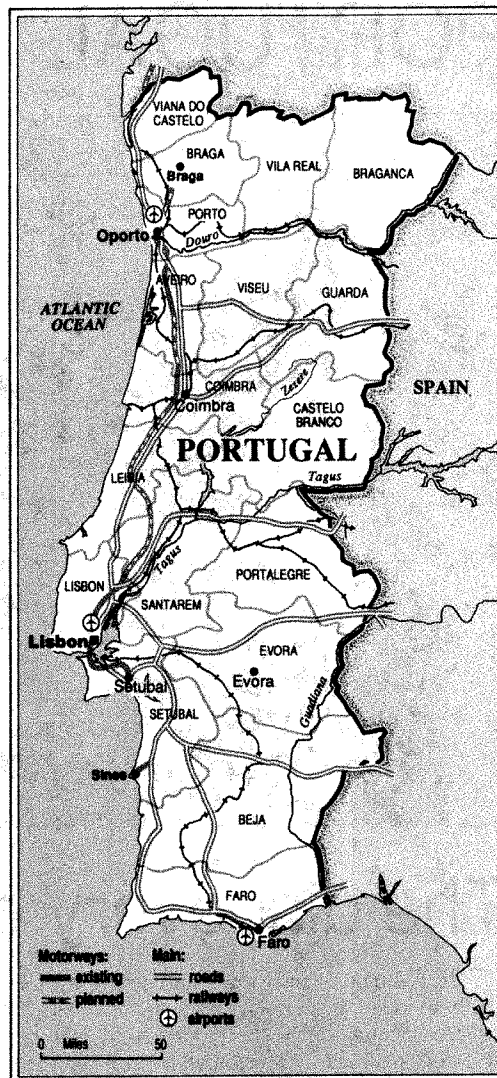
All this has coincided with entry into the EEC. In January 1986 Portugal became, with Spain, the Community's newest member. Most Portuguese, like most Spaniards, had long been keen on joining as a way of legitimising and buttressing their new democracy politically. The economic implications have been slower to sink in.

After 1992 Portugal is supposed to permit free capital flows across its EEC borders. Industrial trade is to be opened up completely too by then, and agriculture is supposed to toe the Community line after 1995. Though certainly agriculture and probably bits of financial liberalisation will be postponed, sooner or later the Portuguese will have to stand their ground with British financiers, French farmers, German industrialists—and Spanish everything.

The first two years of EEC membership have gone well for Portugal, as indeed will the next three. Its industrial trade was reasonably open before, and it now has a generous transitional period to full integration during which it will get lots of Brussels money to modernise its economy and prepare for competition. How it uses this envelope of time and money is crucial.

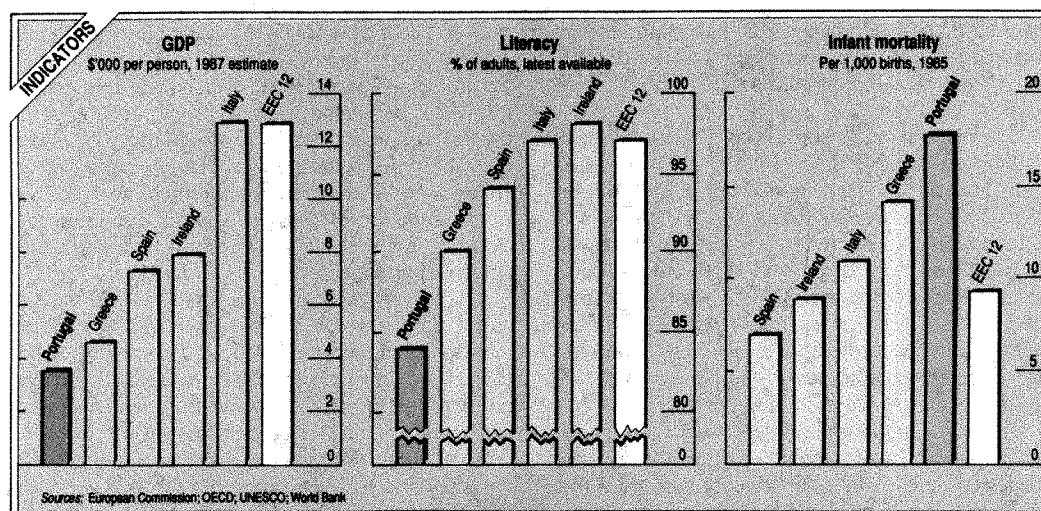
Two futures are popularly bruited—one good, one predictably bad. Portugal could use the money and impetus to change to become a small California in Europe, concentrating on semi-exotic agriculture, services and light manufacturing, even Silicon Valley software, judiciously increasing the value-added in its output to compensate for gradually rising wages. Or, trapped by a long tradition of state dependence and individualistic navel-gazing, it could fritter away the money on ill-evaluated projects and concealed balance-of-payments support. With no clear sense of direction, it might then find itself flooded with high-quality, low-cost imports or, if it is luckier, being bought up by other countries' companies. Though Portugal will probably always be a net recipient of EEC funds, it might then end up as a permanent colony within Europe.

Put in less high-faluting terms, Portugal has the potential to leap from below Greece's level to, say, Ireland's. What are the odds that it will?



Greece or Ireland?

Portugal prides itself on being an open country historically: a land of sailors and discoverers, a founder member of EFTA. Its heritage is a rare blend of races and cultures, its economy traditionally reliant upon foreign trade. Educated Portuguese speak other European languages admirably, a necessity in a country



whose own ancient and honourable tongue resembles nothing so much as windsurfing from consonant to consonant. Foreign employers praise the adaptability of their Portuguese workers. All that should make its adjustment to EEC membership smoother than, for instance, Spain's.

But Portugal is a small country. It accounts for 4% of the EEC's territory, 3% of its population, and less than 1% of its GDP. It has no large manufacturing company outside the state sector. Its three biggest banks together would barely be number one in Spain.

Smallness can be an advantage. It means that Portugal can expand its share of someone else's market (as it did with its exports to Spain last year) without that someone putting up much resistance. But it also means that there may not be the resources to expand all that much. For Portugal is a poor country. GDP per head is still only \$3,500—the lowest in the EEC by a big margin. Furthermore, it is in many ways a backward country.

Though progress has been made, 16% of Portuguese over 15 years old are illiterate, and much of the workforce over 40 years old has had at most six years of schooling. The infant mortality rate remains one of the highest in Europe, higher than in Greece. Communications are another problem, especially in the interior away from the Setúbal-to-Braga concentration of people and business along the coast. Road traffic seizes up going east from Lisbon, while rail transport other than the link between Lisbon and Oporto is archaic. People who try

to telephone one town from another, often wish, a fruitless half an hour later, they hadn't. Statistics are slow and sloppy, too, which makes it hard to plan, let alone fine-tune.

Portugal has a rare opportunity and motive to swap nostalgia for its vanished world role for a toughly competitive future within modern Europe. The opportunity is neither open-ended nor easy, however. The country needs not only better infrastructure and education but specifically more economic head-room for the private sector—and as fast as possible.

But speed has its costs, and these are hard to judge in a country where revolution is recent and democracy new. The government's attempts to ram through needed but unpopular measures this year (freeing labour laws, returning much expropriated agricultural land to its former owners, selling chunks of state companies) have led to a recent souring of political relations, an increase in strikes and a decrease in its popularity. That matters, because there is more work to do.

The next four years are crucial for Portugal and its current leader. There are local and European parliamentary elections next year. In 1991 both president and government must stand for election. In the last six months, Portugal assumes the presidency of the Council of Ministers in Brussels. The task is to push forward change while preserving the social harmony that has recently built confidence in Portugal at home and abroad. It can be done. The chances are it will.



Man at work

EVERY public figure says something that lives to haunt him. Mr Jimmy Carter lusted in his heart; Britain's top civil servant, Lord Armstrong, was economical with the truth. Mr Cavaco Silva, as a young finance minister, said something to the effect that he was never wrong and rarely had doubts. His critics have never forgotten it.

He has little, so far, to feel doubts about. He has got Portugal off its merry-go-round of ineffectual Italian-style minority governments and into a position to make some serious changes. By the time he came along, of course, Portugal was ready for someone like him.

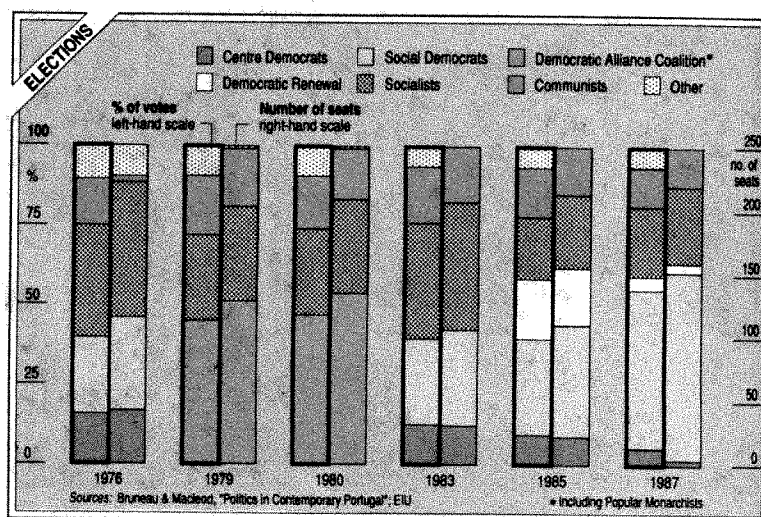
The two years after April 1974, when a group of professional soldiers kicked out Salazar's successor and found broad popular support, saw six provisional governments, increasingly left-wing until August 1975. They presided over the nationalisations, a large increase in wages and social benefits, and independence for Portugal's African colonies. General elections in April 1976, in which the Socialists did best, were followed by four years of minority, coalition and "presidential" governments. The first two, led by Mr Mario Soares, consolidated the welfare benefits of its predecessors and applied to join the EEC.

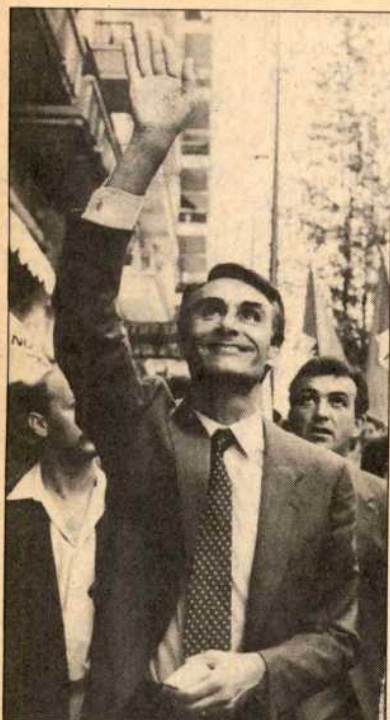
From 1979 a centre-right coalition dominated by the Social Democratic Party (PSD) put first the vivid Francisco Sa Carneiro and, after his death, Mr Francisco Balsemao into the palace of Sao Bento.

They abolished the last institutional remnant of military rule, the Supreme Council of the Revolution; reduced the powers of the president, who now can merely delay, not veto, legislation; and trimmed the ambit of a 1977 law which reserved certain economic activities to the state. The economy, meanwhile, vastly overheated.

General elections in 1983 brought back the Socialists, who in coalition with the PSD presided over a tough IMF adjustment programme. They were

Democracy has settled down in no time flat





Men of the moment: Silva...

penalised for it in October 1985. Socialist votes dropped sharply and the PSD, now led by a youngish economist called Mr Aníbal Cavaco Silva, emerged the winner.

The 1985 vote was an important turning point. Under all the chaos of governmental alliances, voters had tended, year in and year out, to rank parties in the same order. Except when their opponents formed coalitions, the Socialists always came first, the PSD next, the Communists third, the Social Democratic Centre Party (CDS) fourth, with splinter parties taking a small and decreasing share of the total. In 1985 the PSD moved ahead of the Socialists, and both the Communists and the CDS began a decline which has accelerated since then. A new party, Democratic Renewal (PRD), a vehicle for the popular about-to-be-ex-president General António Ramalho Eanes, got a lot of votes that it would later lose.

Mr Cavaco Silva ruled for a year and a half with the reluctant support of the non-Communist opposition. He was a popular prime minister. With renewed economic prosperity, he could afford to spend more—and did. He asked for a majority to carry out the structural reforms, including privatisation, that the country needed. Forced to go to the polls in July 1987, the voters gave it to him.

It hardly matters whether the Portuguese voted for the man, the party, the platform, or none of them. Policies, for the moment, are less important than personalities in Portuguese politics. Three of the five main parties support roughly the same platform of privatisation, modernisation of the economy and structural change. They are entering Thatcherite Europe and think they know what that requires. Competitiveness, not social justice, is the rallying cry these days.

Nor is it clear, yet, that there has been a permanent broad shift in political preferences. In the presidential elections a year earlier, in which two-

termer General Ramalho Eanes was ineligible to stand, the Socialist Mr Soares beat Mr Diogo Freitas do Amaral, founder and ex-leader of the righter-wing CDS who ran with PSD support, by a whisker. In European parliamentary elections on the same day as the national assembly vote in 1987, the PSD won only 37.4% of the ballots, the CDS 15.4%. For its prime minister, Portugal wanted a man who could govern. It got one.

It is said that the Portuguese, and not only right-wingers, are hypnotised by the image of the strong man. The writings of Fernando Pessoa, a poet who was born 100 years ago, are full of Sebastianist yearnings for a reborn saviour. Purged of its Salazarist overtones, Mr Cavaco Silva seems to fit the bill for many.

At 48 a well-preserved double of the young Anthony Perkins, he is intellectual, ascetic and, above all, self-confident. Born to lower middle-class parents in the Algarve, he made his way on brains and discipline to, among other places, York University to earn a doctorate. He taught economics, worked at the central bank and was finance minister and head of planning before becoming prime minister.

He is known as a technocrat not just because he is first-rate at a specific skill but also because he has and cultivates the image of being something above your average politician. He is no backslapper, no dropper-in for drinks. He is incorrupt, and insists that his political associates be too. He is said to loathe political marketing and advertising. Although animated, he is not a horsetrader and lacks the common touch. This is where the president, Mr Mario Soares, comes in.

A monarchy without a monarch

The Portuguese describe their country as a monarchy without a monarch. Unlike Spain, where the young King Juan Carlos played a central role in the country's smooth shaking-off of dictatorship, Portugal's longer-retired royal family was allowed to languish in obscurity by Salazar. Only a tiny monarchist party ever thought seriously about them again. Some blame Portugal's rough ride to democracy on the absence of some such reassuring presence.

But one man provides a fair part of what kings are supposed to do: continuity with the (albeit recent) past, a sympathetic yet glamorous image of what it is to be Portuguese and a likeable face abroad. Mr Mario Soares, the 63-year-old president, is far more popular in the role of "King Mario" than as a somewhat ineffectual three-time prime minister. A charismatic, plumply easy, polished old-stager, his political antecedents amount practically to a dynasty in Portuguese terms: his father was a minister in the days of the First Republic.

In sharp contrast to his predecessor, Mr Soares has abolished the battle of the two palaces—Belem, his own, and Sao Bento, where the prime minister lives. The two have had their differences: for example, Mr Soares felt the government was being too stingy with pay rises for the armed services. In general, however, the two project teamwork. In Bonn recently, Mr Soares praised the two parties' consensus on structural reforms, saying that "cohabitation Portuguese-style is turning out to be different from the French and more fertile."

It is important that it stays that way. The gov-

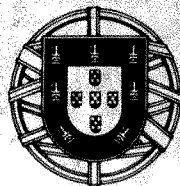


... and Soares

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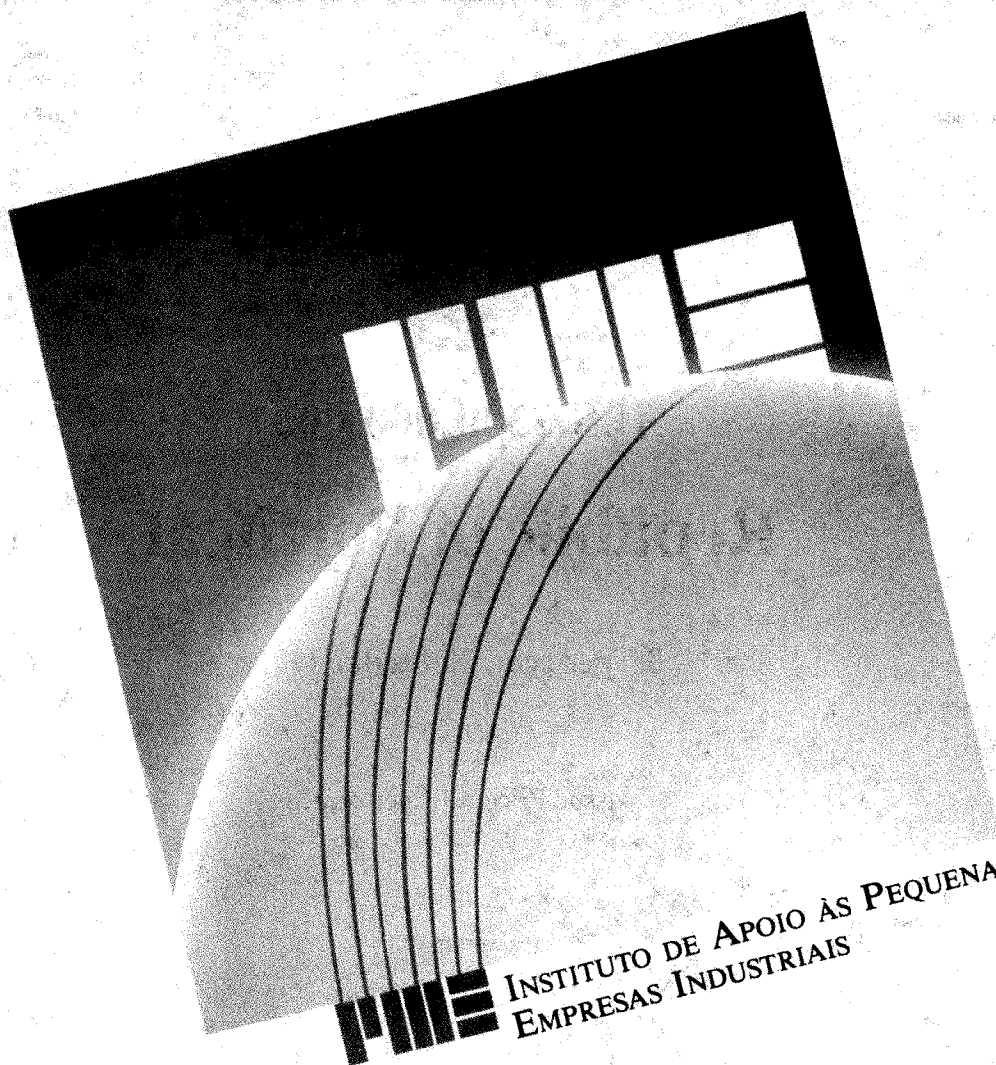
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ernment is halfway through repealing three bits of post-revolutionary law that have the economy in a half-Nelson. The labour laws of the 1970s have been rewritten, to give employers greater freedom to fire workers and to hire them legally on contract. After some apparently messed-up negotiations with the trade unions, the PSD got the measures through the assembly in April, but not before big demonstrations against them, including a fairly general strike.

An agrarian-reform package put to the assembly in early May is supposed to sort out the confusion over expropriated land in the south. The new laws would break up many of the remaining collective farms, give most of the still-occupied lands back to the original owners or their heirs and offer fairly meagre compensation. Less important bits of the legislation include incentives for pooling tiny holdings in the north and slightly less rigid farm-tenancy rules. The PSD has the votes to push this one through, and it will.

In March the assembly approved a new law paving the way for partial privatisation of some of the companies nationalised in 1975 and another law authorising the complete sale of state-owned newspapers. Full privatisation and indeed full reform of farm ownership will not be possible until the constitution is redrafted and the protection that it gives to "conquests of the revolution" bites the dust. This, the trickiest of a tricky lot, will require a two-thirds majority of the national assembly which the government does not have. Though the Socialists agree with the general drift of the changes, they want to use their rare moment of influence to secure

some changes of their own on different subjects. Mr Cavaco Silva says that he does not want to carry through constitutional reforms if he cannot do them properly. He seems prepared to wait.

The prime minister attracts two sorts of almost-contradictory criticism these days. He is blamed for not having moved faster with reforms, and specifically for not having pressed for constitutional changes when his electoral victory was fresh. "They ruled very well when they had a minority government," says Mr Pedro Ferraz da Costa, head of the Confederation of Portuguese Industry. "Now they have lost momentum. They don't know where they want to go." Meanwhile, others complain about his abrupt, no-compromise style. "They have to learn to compromise. They have been too arrogant," claims Mr Vitor Constancio, head of the Socialist party.

Mr Cavaco Silva replies that complaints that he does not consult or compromise "won't stick: consultation does not mean consensus." He thinks that by refusing to placate special interests, he preserves the national interest. "It is not authoritarianism," he says.

Whatever it is, it is losing him popularity. In its April monthly opinion poll, the weekly *O Expresso* found a positive rating of 43% for the prime minister, down from 69% as recently as November. Mr Soares's positive rating, by contrast, was 70%, only a little down from its peak. All this would matter more if the figures were 20 points lower or if other political leaders showed strong signs of attracting the dissatisfied. So far they do not.



Too loyal opponents

AS VOTERS desert the extremes for the middle, the only party seriously to challenge the PSD is the Socialist party. Since Mr Soares was translated to grandeur in 1986, the party has been led by a man every bit as technocratic as the prime minister. Mr Vitor Constancio, head of the central bank during the last Socialist government, is thoughtful, intelligent, respected: what he lacks in charisma he makes up for in competence and incorruptibility. He looks, in fact, like an admirable leader for a centre-right party. Yet his Socialists re-elected him as party leader in February with over 90% of the vote. That is more than the popular Mr Soares ever got.

It seems the obvious moment for the Socialists, who lost votes to the PSD in 1985 and 1987, to start winning them back. They may do so, but not yet. The party's popularity is edging up, but only slowly. Mr Constancio's approval rating in the April poll was 26%, about the same as the previous month, but lower than February's 31%.

The difficulty for the Socialist party, given its relatively low-key leader, seems to be its lack of a clear identity separate from that of the governing PSD. The party is centrist and unradical, rather like its Spanish counterpart. "We have our differences with the government and we have been showing it," says Mr Constancio. "But we want to operate as is normal in a European democracy." There is genuine consensus on many issues. Responsibly, the So-

cialists are anxious not to contribute to destabilising the newly stable government. They want, too, to be the normal alternates in power. All that implies pulling a few punches.

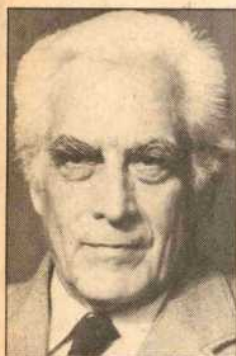
For all Mr Constancio's solid party base, there are others who could challenge him, stressing social justice over competitiveness. The most obvious is Mr Torres Couto, leader of the moderate trade union, the General Union of Workers (UGT). Formed in 1979 with the encouragement of the Socialists, the Social Democrats and foreign organisations, the UGT is still smaller than the Communist-dominated General Confederation of Portuguese Workers (CGTP). Though most of its members are Socialists it has no institutional affiliation to that party, and a growing minority of its members have voted for the PSD. The union and Mr Torres Couto played a prominent role in the general strike in March. In April the poll found Mr Couto the most popular of all union leaders—and ahead of Mr Constancio.

Another possible is Mr Antonio Barreto, a former agriculture minister from Mr Soares's first government who has returned to politics after a spell of voluntary exile as an academic. Currently the party's official spokesman on education and unofficial adviser on agriculture, he needs to build a base in the party. Three or four competent and liked Socialist delegates could also give it a go if the party were

No room at the top?



Competent
Constancio



Hard-line Cunhal

to lose, badly, in the general elections in 1991. Any effective leader or candidate probably needs Mr Soares's imprimatur. It is said that he makes life a little tough for the current incumbent. He might be easier on a successor-but-one.

Though the Socialist party has long been resolutely anti-Communist, it is fed by a stream of disillusioned ex-Communists (among them Mr Barreto). The stream could well increase, for the Communist party, the pillar of anti-Salazarist resistance and now Western Europe's last hard-line bastion is in trouble. Its old 18% of the vote has vanished. Fewer than 4% of those polled in April said they would vote Communist now.

The party has two problems. One is the upsurge of a new and younger group within the party itself that wants to pursue less dogmatic policies. The leaders have resolutely tried to sit on it, but can no longer do so privately. The other problem is what seems to be the general deradicalisation of the working class. The Communists say that the CGTP is taking members from the moderate UGT, and not vice versa. But the CGTP seems to be increasingly confined to low-skilled jobs in state industries.

Until now Communists and Socialists have found it hard to make common cause. That may be changing, at least at the margin. Communist and Socialist bank employees ganged up in April to defeat the PSD leader of their union, the most important in the UGT. If the new pragmatists within the Communist party win (which is unlikely while Mr Alvaro Cunhal, the party leader, is there), that will help left-of-centre collaboration against the PSD. If they lose, the Socialists should at any rate pick up new members.

Less obvious are the prospects for the PRD or the CDS. The PRD's vote slipped from 18% in 1985 to 4.9% in 1987, and the withdrawal of General Eanes will probably condemn it to oblivion. The CDS is a different story. The CDS's share of the national vote slid to 4.4% last July from 10% two years earlier, and the most recent poll puts voting intentions at 5.8%. But it cannot be written off. Mr Freitas do Amaral, who left the party he founded to run for president, came back to what remained of it in January. He is a real politician, with something of the Soares magic and maybe more of a mind.

"We are starting again from zero," he says. "The membership is small, the local organisation is weak, and we have no funds." Actually they are a little below zero: Mr Freitas do Amaral owes some 60m escudos from his last campaign. The CDS is stressing privatisation, tax reductions, the fight against red tape, family benefits: all PSD policies in the last election. Mr Freitas do Amaral is focusing on next year's local elections, where he hopes to hang on to most of the party's 12-13% of councils. Beyond that, the 1991 presidential race looks an unlikely shot, with Mr Soares popularly ensconced.

Where have all the captains gone?

One thing that could throw things into a tizzy is the emergence into politics of a formidable military figure. All the major parties except the Socialists considered a military candidate for president in 1986. For the moment, the armed forces have vanished almost eerily from the political scene. General Otelo Saraiva de Carvalho, who masterminded the coup

in April 1974, is in prison. General Antonio Spínola, the first head of government, takes no interest in politics these days. Lieut-Colonel Vasco Lourenço retired from active service in late April and said why to a local newspaper. The armed forces are quietly forcing out those of their number who made the revolution, he says. He is thinking of joining the Socialist party and, perhaps, become active politically. He is 45 years old.

Though there are divisions within the military between the political left and centre-right, they rally in the face of perceived attacks on the prestige of their institution. The loss of Africa has meant a loss of identity: they no longer know what they are here for. Their numbers have been sharply reduced too: today's 39,000 soldiers, 14,000 sailors, 13,000 airmen, even added to some 37,000 policemen of various stripes, are fewer than half the armed forces at their peak. The share of defence spending in the budget has dropped from 50% in 1970 to less than 10% in the second half of the 1980s. There are constant arguments over whether obligatory military service should be ended.

The armed forces are ill-equipped within NATO and many feel it, especially next to Spain. They also feel hard done by in terms of pay. They have fallen behind civil servants and other professions, and this year's pay increases caused friction. The basic complaint is that the armed forces have lost prestige and that their contribution—to the revolution, to society—is deliberately being undermined.

All this does not mean that Portugal is on the verge of another military coup. The armed forces were by and large content to leave government when they did, in 1982. The 25th April Association, which groups those most interested in 1974, is a pacific outfit more given these days to rhetoric than revolution. The armed forces claim to see themselves as the guarantors of free elections, not as active participants. As long as Portugal remains in the European Community, the chances that they will again assume a formal political role must be minimal.

That does not rule out the individual colonel or general leaving the barracks to challenge civilian candidates at the polls, however. Several names are often mentioned as possibles. They include General Mario Firmino Miguel, the army chief of staff, and General José Lemos Ferreira, chief of the general staff, who is due to leave office in August. There are doubtless others.

None of this need keep a prime minister with an absolute majority in the last election and a still-whopping 43% approval rating awake at night. But Portuguese voters are fickle, as a former president, General Ramalho Eanes—whose party went from 18% to 5% of the vote in consecutive elections—found out. So are parties. The PSD turned over two party leaders in four months before Mr Cavaco Silva came along; several senior members dislike him, though they will not act on it if he remains the vote-getter he has been. He has no heirs apparent in his cabinet ready to race to the head of the column. All in all, Mr Cavaco Silva's chances of being re-elected prime minister in 1991 must be rated high. And, for once, the economy is unlikely to prove the ruling government's Achilles heel.



Do Amaral starts from zero

Banco de Portugal

The Portuguese economy is growing at a pace unmatched since the early seventies. The cumulative real growth of GDP in 1986 and 1987 was close to ten per cent, and current forecasts point to a further 3.5 to 4 per cent increase in 1988.

Private investment has been by far the most buoyant component of domestic demand and this single fact underlines the confidence that prevails among private agents. There are good reasons for such confidence. The country is enjoying a politically stable environment, with a Government supported by a solid majority in Parliament, and is in a healthy financial position. This is largely the result of the external adjustment program implemented in 1983-84 and of the favourable international environment as of 1985, but domestic actions also deserve some of the credit. In fact, Portugal used a large part of its terms of trade gains to solve its financial problems. The Government, for one, retained most of the oil-price related savings of 1986 to reduce its borrowing requirements, instead of passing them to consumers through lower prices. Furthermore, the Government and public enterprises have been repaying a large proportion of their foreign debt. The reduction of the external debt and the large increase of fixed investments mean that the benefits from the recent improvement in Portugal's financial position will benefit the economy for many years.

It is also true that private consumption grew rapidly in 1986 and 1987. That was only natural after the austerity of the preceding years. But recent indicators show consumption decelerating to a trend that looks more sustainable in the medium term.

Merchandise exports and receipts from invisibles have been performing remarkably well, making up for most of the increase in imports and thus keeping the current account in surplus.

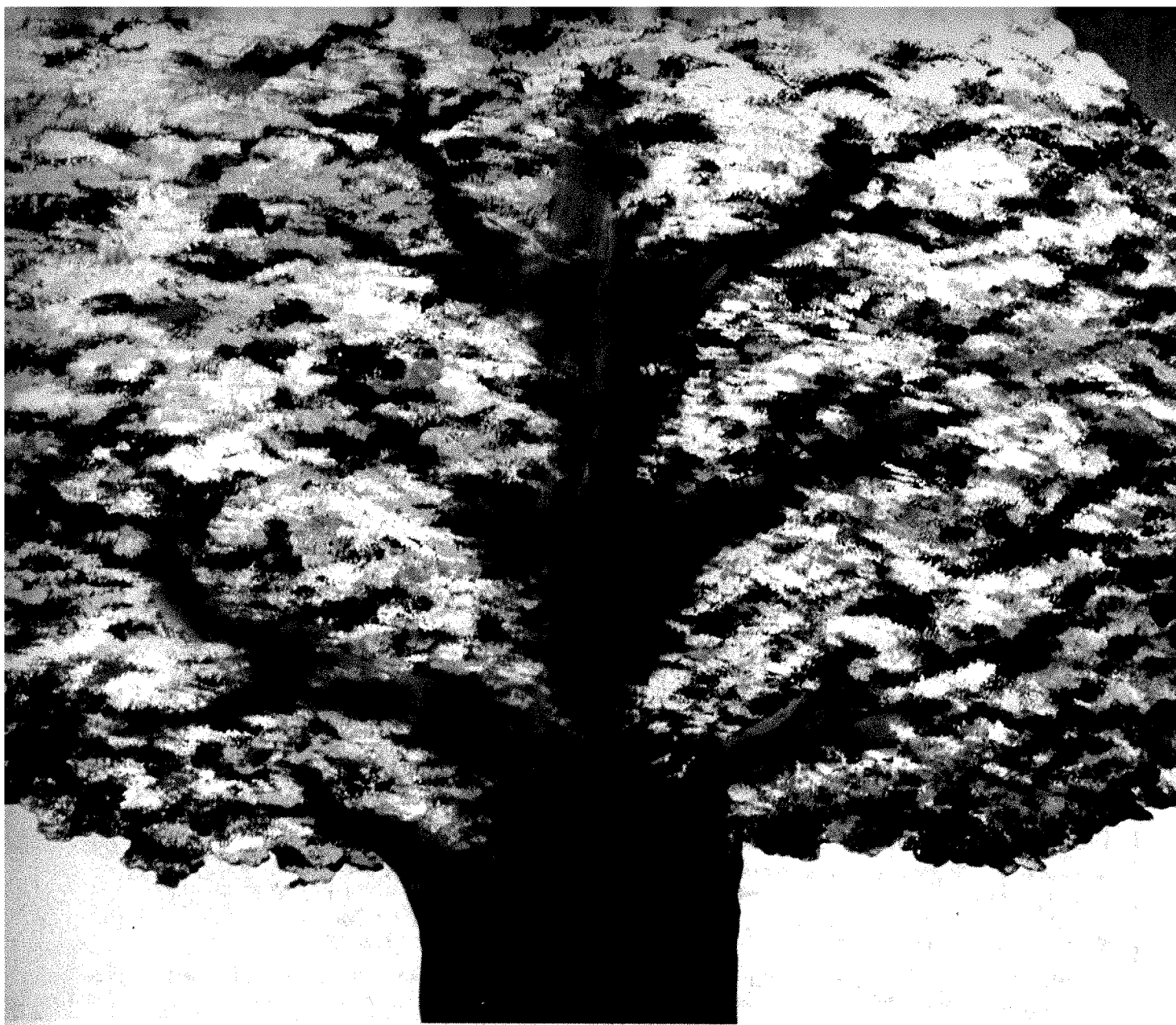
The outlook for 1988 can be summarised as follows:

- Real GDP will grow at a rate between 3.5 and 4 per cent, well above EC average;
- The current account will be in surplus for the fourth year in a row;
- Inflation will follow its decreasing path towards levels closest to EC average;
- Investment in fixed capital will probably display another double-digit real rate of growth.

In spite of these good prospects, Portuguese authorities are not complacent. They wish to use the current room for manoeuvre mainly to invest and modernise, whilst keeping the macroeconomics under control. Wage moderation is still a major policy concern, so as to warrant the fulfilment of the ambitious inflation reduction targets. The agreement reached between the social partners earlier in the year as to the wage guidelines for 1988 was a successful step in that direction. Monetary policy will remain prudent: a target range of 10 to 13 per cent was set for the growth of the liquidity aggregate L^+ , which consists of currency, deposits (both demand and time) of residents and Treasury bills. This target means a further, significant deceleration of the growth of overall liquidity of the economy. Public sector austerity will also continue, with a projected slight reduction of the primary deficit.

This prudent policy stance means that macroeconomic stability is seen as a necessary condition for the sustenance of the current confidence climate amongst economic agents and specially private investors. Among these, foreign investors are showing a particular confidence in business prospects in Portugal. Data for the first quarter of 1988 show foreign investment trebling vis-à-vis the first quarter of 1987 (and in 1987 the real growth rate had already been of the order of 50 per cent). Investors are taking the opportunity to use the comparative (and absolute) advantages of Portugal as a basis to produce for the European national markets and later for the enlarged single European market. In spite of the large growth rates of the last few years, foreign investment is still comparatively small, so that there are plenty of good investment opportunities left. As always happens, the first to take them up will reap the best fruits.

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Growing, growing

"WE ALL learn in the textbooks that confidence is a very important force in the economy," says Mr Joaquim Ferreira do Amaral, the minister for trade and tourism. "In Portugal we learnt it the hard way." Confidence was in short supply until recently, as Portugal tried to make up for three things: decades of low investment in productive and human resources, neglected until the 1960s; the long reliance upon its colonies to provide cheap raw materials and revenue and to buy manufactured goods; and the dislocations of a revolution which, for all the good it did, chased away managers and investment.

Portugal has had two persistent problems: external current-account deficits that touched 13.9% of GDP in 1982, and public-sector deficits amounting to almost 25% of GDP in 1982. The first is under control, for the moment. The second is better, though not better enough.

Because Portugal makes so little of what it consumes, what the Portuguese do to their economy matters less, in the short run, than what others do. It is one of the most open countries in Europe to outside influences. Total trade in goods and services equals 75% of GDP, its gross foreign debt 45%.

Portuguese imports include four-fifths of its energy, up to half its food, and most of its capital goods, just for starters. Policies to stimulate growth quickly end up stimulating the trade deficit. A subtle nudge to wages to encourage demand can quickly turn into a knock-out punch with a small fall in the dollar, the price of oil or world interest rates.

The past decade has seen two go-stop cycles in which growth has had to be lassoed round the knees when the external account got into trouble. Portugal's first constitutional government began spending more than it could afford. Real wages had risen by about 25% in 1975-76, social welfare was increased, subsidies to newly nationalised enterprises were accelerated. Consumption surged, sucking in imports. Portugal signed a one-year stabilisation agreement with the IMF in 1978 and put the brakes on domestic demand.

In 1980-82 expansionist policies, prompted this time by the centre-right coalition government, again led to problems in the balance of payments. Back came the IMF. Portugal ended 1985 with consumer-price inflation (despite undoing a lot of controlled prices and subsidies) two-thirds of what it had been but still running at almost 20%; an escudo which bought about half the dollars it had three years earlier; real wages in manufacturing 15% below their level in 1980; average annual growth over the three years of less than 0.5%; and its first (modest) current-account surplus in years. It was an heroic achievement, but a costly one.

Go-go growth, for a change?

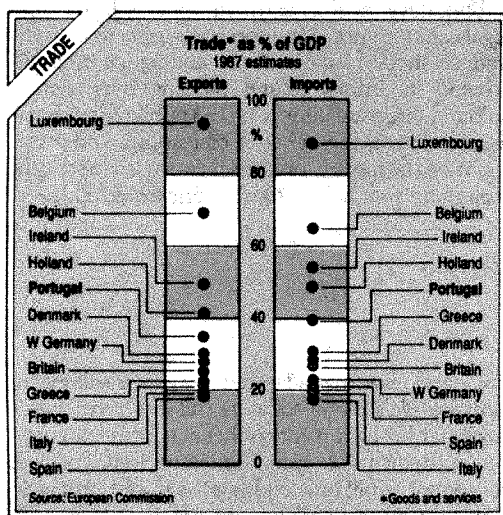
Halfway through a third cycle which might, for once, be go-go, Portugal now has slightly better management and a lot better luck. The stabilisation programme straightened out the external deficit and reduced the growth in debt. From 1985 oil prices, interest rates and the dollar all fell; in 1986 Portugal needed to sell only 88% as much as the year before to buy the same volume of imports, though that figure rose a little in 1987. And membership of the EEC brought more foreign exchange coming in on current and capital account.

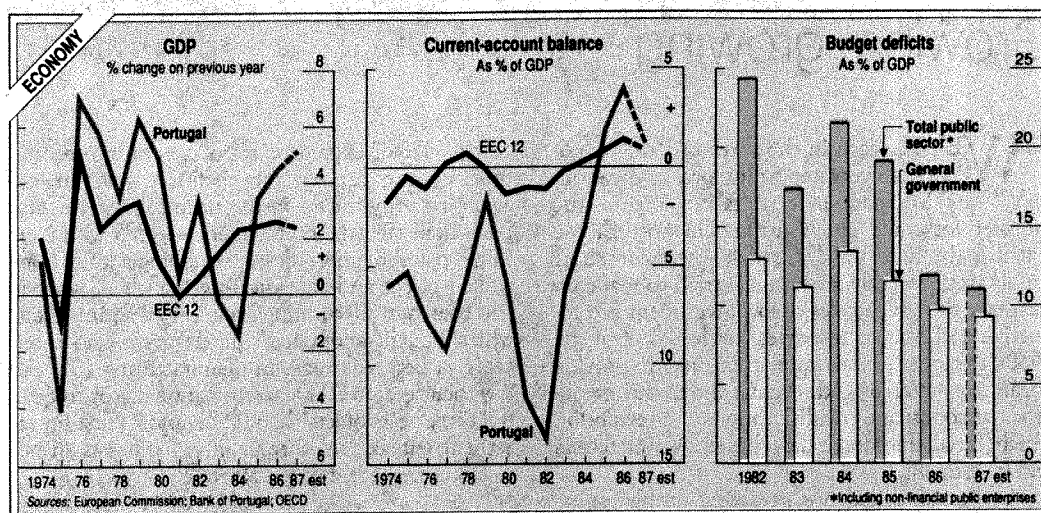
Even officials were surprised by the speed of recovery, as real growth went from 3.3% to 4.3% in 1986 and a likely 5% in 1987. Real wages rose in 1985 and 1986, then a little less in 1987 after the government set up a new system of wage negotiations pegged to future inflation. Real domestic demand, led by private consumption and increases in previously disastrous investment, grew by about 8% in 1986 and almost 10% in 1987. Investment last year rose by 20%. Tax breaks for it made a difference; so did new infrastructure programmes and the first big Brussels money.

All this upset the balance of trade, however. The volume of imports rose by more than 40% in 1986 and 1987, twice as fast as even quite nippy exports. Increased earnings from tourism and emigrants' remittances saved the day, producing a current-account surplus of \$1.2 billion in 1986. This shrank to about \$650m in 1987.

Inflation, meanwhile, which had been over 25% in 1983 and 1984, declined to 8.2% in March 1988 over the previous March. The number of the registered unemployed fell from under 9% to 6.6%, pushed down partly by new youth-training schemes.

At the same time, public finances improved. The government budget had moved into steadily mounting deficit until 1984, when its borrowing requirement was 13.4% of GDP. Public enterprises borrowed too, up to 11.4% of GDP in 1982. Through good luck, good growth and some good policies, the government halved the total public-sector deficit in two years to under 11% of GDP in 1987. Direct taxes were lowered, indirect taxes raised. A new VAT tax in 1986 brought about 234 billion escudos into the treasury that year. Taxes on petroleum products were increased when the oil price fell, almost doubling receipts from it. The fall in import prices al-





lowed cuts in subsidies to state enterprises.

Most people now agree that the time has come to cool down a bit. (Monetary policy has tried to be cool since the first half of 1987.) The government reckons GDP growth in 1988 will be 3¼%, though some other estimates are lower. The current account is officially expected to show a surplus (the OECD predicts a slight deficit). Private consumption growth is to be halved, mainly through rationed bank credit and higher interest rates. Inflation is optimistically put at 6%. Total public-sector borrowing is estimated at 10.5% of GDP, which is about the same as last year.

So much for year-to-year changes. Portugal's medium-term strategy, set out in a programme in March 1987 and updated in January 1988, is to encourage greater competitiveness through gradual structural change while pushing investment-led growth above the EEC average. Policy makers accept that this may unbalance the current account until 1994. Reducing the public-sector deficit as a percentage of GDP to half 1987's level by 1990 is another goal. So is reducing inflation to EEC levels by 1989 (and, officials say, at some point to follow Spain into the EMS).

The mere fact that a reasonably thought-through medium-term strategy exists, and that it comes from a government which has a medium-term future itself, is a plus. Some of the goals (real wages, investment, growth) look more feasible than others (inflation, public-sector deficit), however.

The strategy thus implies a widening trade deficit, probably taking the current-account deficit with it; and a reasonably expansive budget. Portugal can afford the former for a while. It has plenty of foreign capital flowing in and reserves (including gold)

equal to about half its foreign debt. Since late 1985 it has renegotiated and repaid slices of that debt, and expects to make similar net repayments this year. The budget ideas may be riskier.

The prime minister is very much in charge of economic policy in his country. When Mr Cavaco Silva was finance minister in 1980-81, he presided over the beginning of an unsustainable boom. He will not wish to repeat the experience. But there is not much room for spending cuts in Portugal's budget. The government can hardly reduce social spending after last year's campaign promises to increase it. Most EEC money requires counterpart funds from Portugal. The treasury's otherwise-desirable shift from borrowing from the central bank to borrowing from the market has raised costs too. A quarter of current expenditure is earmarked for debt interest. That leaves cutting civil servants, and cuts are planned.

Raising money without actually making anyone pay all that much looks the best answer. Privatisation is one of the government's great white hopes. The overhaul of direct taxes planned by the finance minister will replace a jumble of taxes with a simplified personal tax and a corporate tax on income from all sources. It should enlarge the tax base, close loopholes, lower rates and raise money, but not until 1989.

Whatever problems the future may bring, Portugal can, for once, count on a few years to concentrate on modernising industry and agriculture; improving its infrastructure; tackling overweening public enterprises; improving the public administration; and investing in better education. And it can count on the money. Brussels is proving a more generous fairy godmother than anyone expected.

Joining the club

Christmas all the year round

"MY GENERATION saw joining the EEC as a political growing-up, without thinking too much about the economic consequences," says Mr Fernando Ulrich, executive director of the Banco Portugues do Investimento. "Those are now beginning to sink in." Yet for all the talk of the blood,

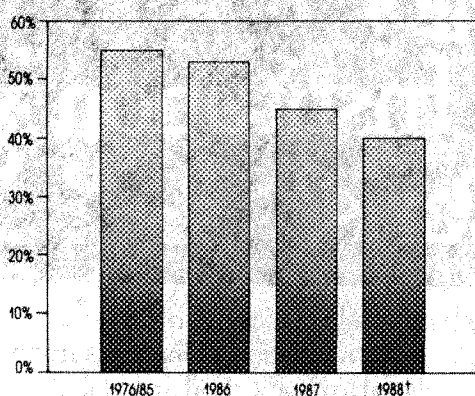
sweat and tears that adapting to Europe will mean, most people's mood today is still euphoric. Entry has so far brought plenty of benefits with few costs.

In the first two years of membership, Portugal got some 137 billion escudos gross in cash from the Community, or 88 billion escudos net. (That is on

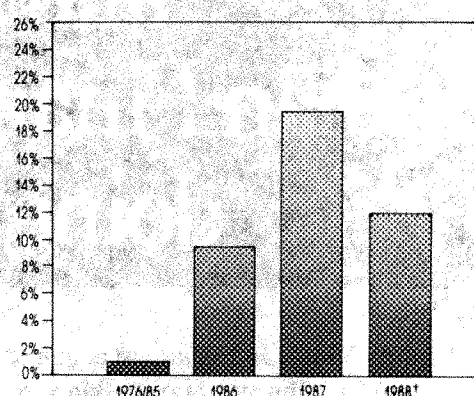
P O R T U G A L

A MACROECONOMIC STRATEGY FOR CONTROLLED PROGRESS

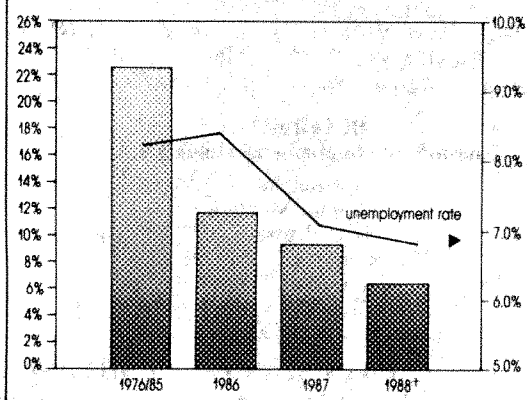
EXTERNAL DEBT
as % of GDP



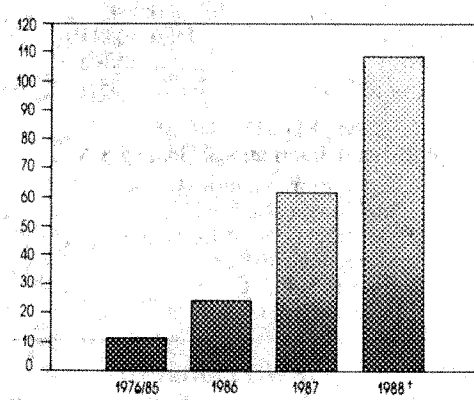
GROSS FIXED INVESTMENT
Real growth rate



INFLATION and UNEMPLOYMENT
CPI growth rate and unemployment rate

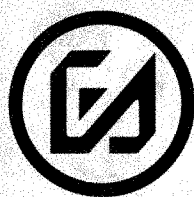


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Billion Escudos



MINISTRY OF FINANCE

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figures from the finance ministry; everyone calculates it differently.) The ministry reckons that 1988's net inflow will be more than one-third higher than last year's 55 billion escudos. Most of it comes from the "structural funds" and is being spent improving things like roads and railways, telephones, training, irrigation. Agriculture absorbs about 30% of it. Portugal's trade with the Community has doubled since 1985. Its balance, however, has flipped from rough equilibrium to a deficit of 284 billion escudos in 1987. Early 1988 showed a similar trend.

Foreign investment has been flooding in. Portugal looks likely to double its previous stock of foreign investment in its first three years of membership. From January 1986 to the end of March 1988, more than two-thirds of the new capital came from EEC countries.

One reason for the relative lack of angst is that many of Portugal's imports of non-agricultural goods already came in lightly taxed or untaxed. Unlike Spain, Portugal was an EFTA member when it joined, and the EEC and EFTA had lowered trade barriers. It also has had a special agreement with the EEC since 1972. Over half of Portugal's imports were from the two groups.

The other reason is that Portugal negotiated itself a sweetheart deal for at least five years. The walls around its domestic market will fall slowly, while EEC money pours in and Portugal's own products (textiles, for instance, and tomato paste) get better and faster access to the rest of the Community.

Under the terms of the accession agreement signed in June 1985 (Portugal has a separate deal with Spain):

● **Industry.** Portugal is to phase out its tariff barriers against imports from the EEC in seven years. Tariffs on non-agricultural imports from third countries (outside the EEC and EFTA) are gradually being reduced from their average 1985 level of 16% to 5% by 1993. Though Portugal can keep quotas on some products from Japan, GATT and Eastern European countries for seven years, the quotas must rise. Meanwhile, quotas on Portuguese exports to EEC countries are increasing more quickly.

● **Capital.** Portugal undertook to phase out restrictions on capital movements in seven years too. Direct investment from EEC sources is to be free after four years. Portugal already has liberal rules on the repatriation of capital and profits from foreign investments.

● **Agriculture.** For 85% of Portugal's farming, EEC tariffs and prices were to be phased in over ten years, in two five-year stages. Some products like wine, olive oil and processed tomatoes are subject to Brussels rules earlier. There is also a ten-year transition on fishing.

● **Financing.** Portugal will collect EEC levies and duties on third-country imports of most agricultural products during the first five years; but it does not have to hand the money over to Brussels. Since 1986 it has been paying to Brussels the EEC's common external tariff on imports of other products. It also gets a refund of its VAT- or GNP-based contributions, a refund that will be steadily reduced.

Portugal, too, is eligible for a special grant of 700m ecus (roughly \$850m) to help restructure its agriculture from 1986 to 1995. A number of grants are available from the European Regional Develop-

ment Fund (for which the whole country qualifies), the Social Fund and the Agricultural Guidance Fund. The state and private sectors are to have special access to project-related loans from the European Investment Bank.

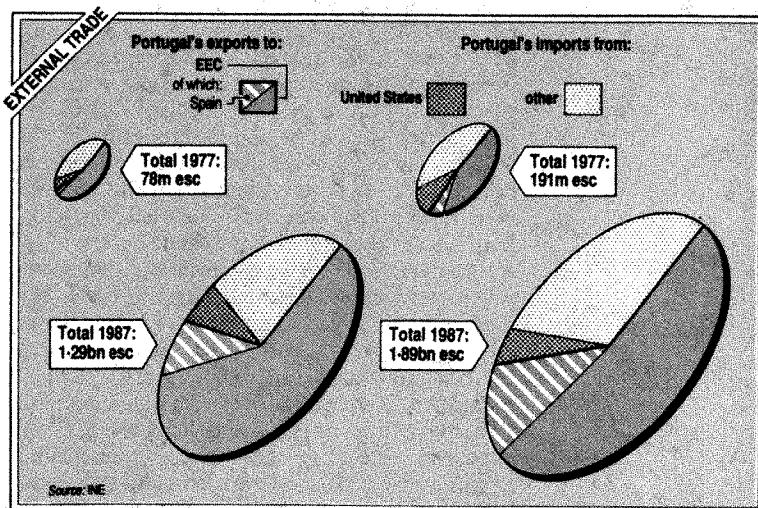
Along with the EEC deal, Portugal and Spain have rewritten their own bilateral rules. Essentially, Portugal extended to Spain the same terms it had fixed with the rest of the Community. Spain, which has much slower EEC integration rules on industrial products, gave Portugal especially privileged access. Portugal's duties on industrial imports from Spain had been lowish, while Spain's on imports from Portugal were as high as 50% in some cases. Spain and Portugal agreed to abolish from January 1986 all duties on industrial trade between the two countries except in textiles, tomato concentrate, cork and some petrochemicals. In November 1987 textile trade was eased, and other adjustments made.

The biggest immediate impact of joining the EEC has been Portugal's vastly increased trade with Spain. Spain is now its fourth largest market in the Community taking more than 9% of Portugal's total exports. In two years Spain has jumped to being Portugal's biggest supplier after West Germany, providing almost 12% of its imports in 1987. Portugal, however, has increased its exports to Spain even faster. Whereas in 1986 Portugal's exports to Spain paid for only 48% of its imports from it, in 1987 that ratio had risen to 53%. In the first two months of 1988, by contrast, Portugal's purchases from Spain increased more steeply than its sales to it, widening the bilateral trade deficit by 73% over the same two months a year earlier. Officials are worried.

When the party's over

From the early 1990s things are supposed to change. Portugal then has to start paying its full VAT contribution plus third-country levies to Brussels, and begin repaying some of its loans. Structural funds will probably have shrunk in real terms, though Portuguese farmers will be qualifying for more automatic guarantee funds. The flow to Europe's poorest country will probably always be kept positive, but not as much as it has been.

EEC deadlines are always a movable feast, and two things are shoving them back now for Portugal.





One is the Community's general financing crisis—resolved, for the present, by the Brussels summit in February 1988. The other is the drive towards a single internal market by 1992.

For Portugal, even more than for Spain, the single market is one of those great ideas that it would really like to take seriously in around 20 years. The two newcomers have only started breasting the first wave of tariff, price and tax changes which the rest of the Community has assimilated. They are worried about being knocked off their feet by the second wave—the removal of technical barriers to trade that their fellow-members are ready to undertake. Hence when people in Britain or Holland talk about an “internal market”, their equivalents in Portugal, Spain and Greece answer “social cohesion”. That means, basically, agreeing to further liberalisation at the price of more money and more time to get ready for it.

“Our two goals now are to consolidate the ideas of the Brussels summit and to move harmoniously towards the internal market,” says Mr Vitor Martins, Portugal's secretary of state for European integration. The Brussels summit had three main implications for Portugal. The heads of government agreed to double the regional funds for less developed regions, but left unsettled exactly how to divide the bigger pie. The Brussels summit also agreed on the details of a new Portuguese industrial development fund, worth 2 billion ecus in grants and loans between 1988 and 1992.

The agreement to reduce the growth in agricultural spending means that Portugal will need more time to adapt its own (higher) farm prices. Portugal has got an extension of up to five years, mainly on cereals. It wants and will get exceptions from other single-market deadlines: on fiscal harmonisation, for instance. Cynics say that only in Portugal is 1992 reckoned to be in the twenty-first century.

One likely change from Community membership, hard to measure, has to do with how Portu-

gal's own government and bureaucracy function. The Portuguese are rather good in Brussels. Like the Irish when they tagged along behind Britain, less was expected of Portugal than of co-jointer Spain, and its needs were perceived as real. The Portuguese have bent over backwards to learn their briefs. Some say it is easier to deal with them than with the Spaniards, whose first offer is all too apt to be their last. It is also cheaper: yielding to little Portugal costs pennies, giving in to Spain costs pounds.

But Portugal in Brussels depends on the bureaucracy at home, and that—large, unwieldy and low-tech—is not one of Europe's best. Many of the bright people in it appear desperately overworked, perhaps because so few of the really incompetent ones are fired. The civil service needs to be modernised, more productive, better paid and computerised, says Mr Miguel Cadilhe, the finance minister. A start has been made: the customs service has new computers.

Those Portuguese who are not mesmerised by the flow of cash and camaraderie from Brussels have the odd worry about just what the EEC will do for Portugal. Some worry that Portugal's farmers and small businessmen are too uneducated and too poor to put together enough projects to get all the money they are entitled to. Others worry about just the opposite, that too much money will come in, wreaking havoc with the money supply and, through matching funds, with the budget. Portugal wants Brussels to reduce its co-financing requirement from an average of 40% to 25%.

One risk is that with cheap money available, people will throw it about. Subsidised investment has artificially lowered the cost of capital, obscuring the need to choose investment projects with the greatest returns. That is where matters could go wrong in Portugal, which left to its own devices is longer on labour than on capital. Unemployment has not yet reared its ugly head, as it has in nearby Spain. It will.

School time

*Put your money
where your
men are*

“PORTUGAL is a country which has exported manpower more than it has imported capital,” says Mr Vitor Corado Simões, an economist who is now assistant director of Portugal's Foreign Investment Institute. Some 2m people emigrated permanently or temporarily between 1950 and 1970, a total equal to about three-fifths of the workforce in the latter year. At its pre-revolutionary peak in 1972-74 of about \$50m a year, direct foreign investment in companies was not even 0.5% of GDP. Both sides of that equation are changing.

By the early 1980s legal emigration from Portugal was running at a quarter of its 1970 level. The independence of its former colonies brought over 700,000 people back from Africa. Aging emigrants are beginning to return too. Portugal's resident population, at something over 10m today, is almost 1.5m higher than in 1970. And, like Ireland, Spain and Greece, it has one of the youngest populations in Europe, with 23% under 15 years old. Half of the Portuguese between 15 and 24 want to work—again

a higher rate than in much of Europe.

Surprisingly, the labour market is so far absorbing this megablip on the demographer's screen. With over 4m in work today, the percentage of registered jobless is officially reckoned to be 6.6%. Underemployment is rife, but so is Portugal's black economy, variously estimated at 10% of GNP (by the Bank of Portugal four years ago) to 20-25% by academics today. Employers say that it can be difficult to hire workers not just for skilled jobs but also for construction.

Wages are rising but are still low. Hourly industrial labour costs in 1986 were reckoned to be the lowest in Europe, at one-fifth the EEC average and one-third even of Spain's. Unemployment insurance and social security have been improved but are still low: job security, at least until the new labour laws, took their place.

Portuguese workers are cheap. Some are also productive. Even within a given industry, there can be huge differences. Officials are increasingly con-



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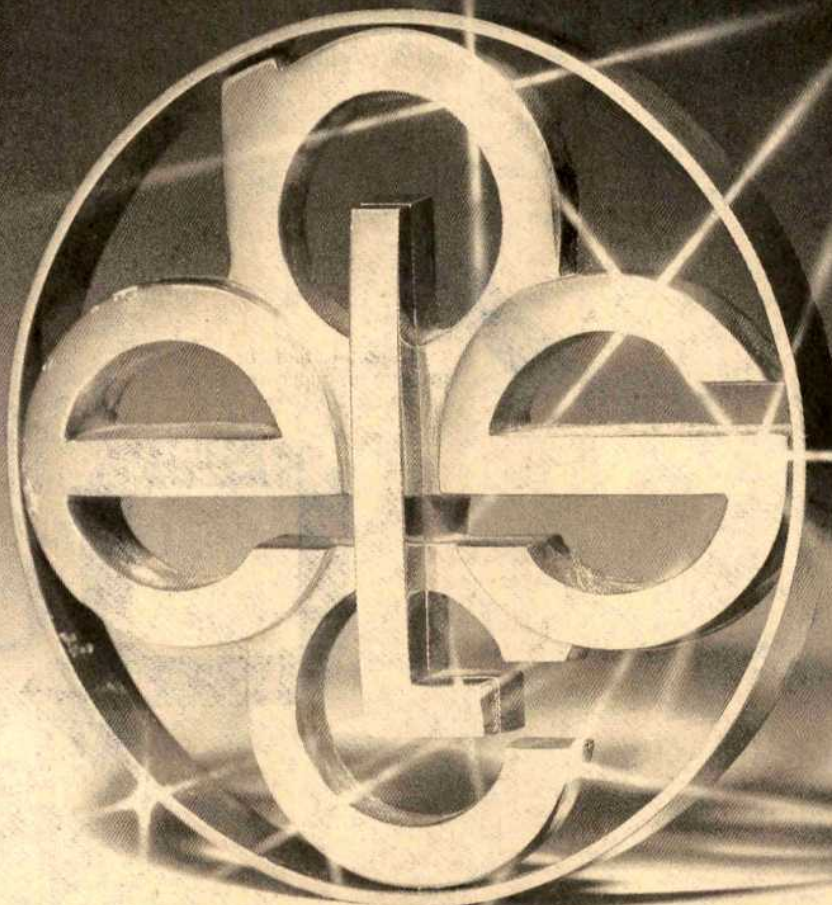
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team

cerned about a gap in skills in Portugal. Mr Roberto Carneiro, an energetic and articulate new education minister, is one of them.

Though Portugal was one of the first countries to introduce compulsory primary education in the nineteenth century, the illiteracy rate, 16% of those over 15 years old, is higher than Greece's. Perhaps 45% of the rural population is virtually illiterate. Some 86% of the total adult population has had a maximum of six years education, the legal minimum until last year.

Failure rates are high, especially in the crumbling schools of rural regions. About 42% fail in the first two years and have to retake their examinations. Only two-fifths of children reach the end of secondary school, and of their number, only 5% receive any technical training. Just over one-tenth go on to higher education, about half the rate in most European countries. Only 3% of the total labour force thus has senior technical or university training.

The number of students in higher education, however low, is still, at 120,000, four times higher than 15 years ago. There were four state universities then; now there are 12, plus 14 polytechnic schools. Private universities are proliferating too. Since last autumn children entering school will have to stay there until they reach 15. Teachers are being trained and retrained, and in 60 poor municipalities, 130,000 children started getting a free meal a day this year. Some of the biggest battles are over the school curriculum, which is now under exhaustive public debate. Mr Carneiro wants to give one-third of children vocational or professional training and make other changes too.

Mr Carneiro has many other targets. He wants to reduce illiteracy to 10% by 1992, increase the promotion rate in primary schools to 95%, get 75% of students to the end of secondary school and increase the proportion that will go on to higher studies to 20%.

That—like building roads and railways, the other main priority now—will cost money. The government is taking it seriously. Education accounts for 12.4% of the 1988 budget; last year its share was 11%. Over four years, however, Mr Carneiro reckons they will have to invest \$2 billion-2.5 billion in education, well beyond even the ablest cabinet infighter's means. The EEC will come up with some of it, and has already made a start.

For all the education system's current shortcomings, many foreign employers praise the "adaptability" of their Portuguese employees. GM, for instance, reckons that productivity at its assembly plant in Portugal is better than in West Germany or Britain. Ford is considering making in Portugal the new electronic engine control device that it has decided against producing in Scotland. With specific reason, perhaps: in many industries Portuguese are notably more productive working for foreign firms than for Portuguese companies.

Para ingles ver

Though some foreign firms have been established in Portugal for ages, foreign investment was not really encouraged until the 1960s. By the early 1980s foreign affiliates accounted for just under 20% of all manufacturing sales, and close to half in industries

like electrical, engineering and motor parts. The record of foreign investors in Portugal is, however, mixed.

Foreign investment helped to restructure Portuguese industry towards more high-tech and skill-intensive businesses and improved its international competitiveness. The Portuguese used to use the term *para ingles ver*—for the Englishman to see—to describe articles made to higher standards than usual. On the negative side, foreign investors shipped home their profits, stayed in import-dependent enclaves, and perhaps inhibited the development of local competitors.

The current wave of new investment seems rather different. There is more of it, for a start: 1987's 62 billion escudos was two and a half times the previous year's rather depressed figure and a record. Most of it went to expand existing operations.

Two-thirds of the new money headed into services instead of manufacturing, confirming the trend of the past few years. Retailing is a favourite target. Marks & Spencer opened in Lisbon in April this year, and Spain's El Corte Ingles is looking for a site there. A little less than a third of the total was spent in manufacturing, including two big projects in glass and one in wood. All three were by Spanish-incorporated companies.

The big news in 1987 was the emergence of Spain as a close second to Britain in the league tables of foreign investors, and ahead of Portugal's traditional leader, France. Whereas British investment is going mainly to develop tourism, much of Spain's is heading into light industry and commercial distribution. A bigish portion of Spain's total, which some reckon as much as two-fifths, represents investment by the Spanish subsidiaries of foreign multinationals. Saint-Gobain, a French glassmaker, spent over 3.5 billion escudos via its Spanish subsidiaries, for example.



There's always tomorrow



Foreign investors have one big complaint about doing business in Portugal. "Don't tell me, I know," says Miss Raquel Ferreira, head of the Foreign Investment Institute, "Red tape. We are trying to make that better but it doesn't depend only on us." The 200-odd bits of paper that have to do with investment incentives have become legendary. But the tape has not been enough to strangle new investment. Figures for the first three months of 1988, at 27 billion escudos, are already higher than all of 1986. Firms like Italy's Ariston are investing 3 bil-

lion escudos to build washing-machines; Miele is spending 500m escudos to do the same.

Last year's flood seemed in one sense like a fluke. The biggest single investment, by Manufacturers Hanover's Portuguese subsidiary, was a capital increase of 3 billion escudos, required by the banking authorities. Other banks had to raise money too. But financial services could, in fact, continue to be one of the hottest businesses around. The biggest Eurochanges, and the most successful, have taken place in finance.

1992 and all that

Banks are busting out all over

THE Portuguese are tremendous savers for their barely provided-for old age. In the past five years they have stashed away an annual average of 27% of their disposable income (compared with 3¼% in America and 18¼% in Japan). Take away emigrants' remittances and that still leaves a healthy 17% in 1987. Traditionally almost 90% of those savings went into bank or building-society deposit accounts, with the odd flier on the astronomical interest rates of the now-bust Dona Branca. No longer: people are beginning to spend more, emigrate less, and save in different ways.

The real revolution in Portugal these days is taking place in finance. Since banking liberalisation began in Portugal four years ago:

- The number of banks has been doubled, as six foreign and six new private commercial banks have been allowed (with limitations) to join the nine nationalised banks and three long-standing foreign ones.
- Banks have started foreign-exchange dealings among themselves, including quite sophisticated forward-rate agreements.
- Administered interest rates have been reduced from a handful to two interest-rate limits.
- A new Treasury-bill market has been formed and is functioning.
- A whole new category of financial firms—investment societies that are something like investment

banks—has been approved, and half a dozen of them now frolic.

- The number of companies listed on the stock exchanges more than doubled in 1987 alone. The volume of trading on the Lisbon stock exchange quadrupled.

- Mutual funds, which started in mid-1986, now manage 54 billion escudos.

Not the least of the revolution is psychological, the yuppification of Portugal. "When I first arrived in 1984, it was not fashionable either to make money or to talk about it," says Mr Nicholas Racich, who works for the almost embarrassingly successful Manufacturers Hanover there. How things have changed.

Foreign banks (including Citibank, Chase Manhattan, BNP—but not Spain's Banco Central or Banco Exterior, which asked to get in) played a big part in dynamiting old ways of doing business, by innovating and lowering prices. Manufacturers Hanover, for instance, brought auctioned syndicated credits to Portugal, lowering the effective interest rate that big borrowers had to pay on medium-term debt by three or four percentage points.

New private-sector banks, like Banco Comercial Portugues or the more wholesale-oriented Banco Comercial do Investimento, had even greater influence in sharpening up prices and services, and in persuading corporate customers to come to the capital markets. New investment societies have done the same, especially the profitable CISF. State-owned banks responded well to the competition, shedding jobs, cutting costs and hustling for business.

Liberalisation has coincided with at least two good years for the banks. Some have always been profitable, such as Banco Espírito Santo, the second biggest bank, and the slightly less lucrative Banco Portugues do Atlantico, the largest. The others began to make money last year. Average return on assets in 1986 was 1.27%, up one-third from 1984, on figures from the Portuguese Association of Banks. It was higher still in 1987. In the first three months of 1988 several banks reported profits or cash-flow up to four times higher even than the same period of 1987.

New foreign banks, mainly wholesale and with fewer bad debts and employees than the state-owned banks, have had the best bargain. Manufacturers Hanover says that Spain and Portugal are its most profitable units worldwide: in 1987 Portuguese operations reported a return on assets of



They have to keep up with the times

4.65% and a return on equity of 40.9%. But margins, though high, are falling, from 5-6% a few years ago. Banks are beginning to compete. They are offering retail customers a fast-expanding range of insurance-linked savings products and mutual funds, as well as funded pensions to their employees.

Reform me, O Lord, but not yet

The government has at times pushed financial reform, at other times dragged its feet. For two big reasons: monetary policy has been exercised almost exclusively through credit ceilings, and the government's own large borrowing needs were believed to require keeping a lid on the private sector.

The rules are now being loosened. Administered interest rates have been reduced to just two—a minimum on deposits and a maximum on loans. The finance minister promises the end of credit ceilings in 1988, though others suspect it may take longer. That implies the disappearance of at least the maximum lending rate. Many officials fear that all the cash sloshing around the interbank market will create an explosion of credit and fuel inflation.

The easing of credit restrictions is the good news. The bad is that, as things stand, banks cannot possibly prepare for 1992 and the opening of financial frontiers. Some 90% of banking has been state-owned since 1974-75. Though the finance ministry, the banks' boss, is getting more flexible and less involved in day-to-day control, state-owned banks are still not free to invest or form joint ventures or take new initiatives without approval. They cannot raise capital on the stock exchange or easily carry through the mergers that are now toughening banks in Spain.

Some bankers still worry about the possibility of political interference in state-controlled enterprises such as their own. Less dramatic but more serious is that pay in the state-owned banks is low, and there are no stock options or performance bonuses. Talented people, especially those who understand computers or who can deal, are fleeing the public sector.

Privatisation could change that. The odds are that the top four and at least one other bank will be sold eventually. They are unlikely to be in the first wave of privatisation, however. They also need capital and the government would rather keep the sale proceeds, thank you.

The government has shaken up the capital markets too. It is moving its new debt from the Bank of Portugal's back door to the markets, acquiring a new tool of monetary policy. Treasury bills, introduced in 1985, have been a great success. Outstanding bills rose from 150 billion escudos at the end of 1985 to 800 billion escudos two years later. Over two-thirds were held directly or indirectly by the public. Longer-term government securities should come next.

The real problem for the government and the real limit on financial liberalisation is the sheer size of government borrowing, its effect on inflation, and its impact on corporations seeking finance. People disagree on whether the government is actually crowding out productive investment. Bigger companies have learned to borrow abroad. And last year Portugal's stock exchanges suddenly offered a new way to raise capital.

"Any company that has even a two-to-one debt-

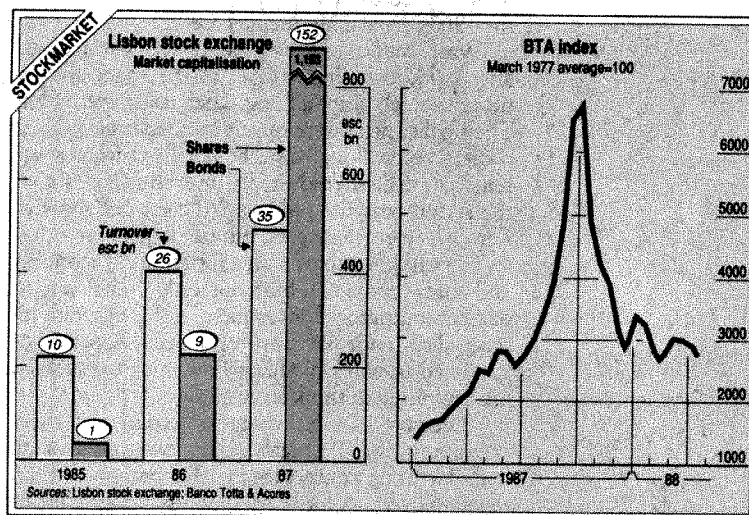
equity ratio is automatically a blue chip here," says the boss of one that does not. That ratio looks like changing. Only 50 companies were quoted on Portugal's two stock exchanges (Lisbon does at least two-thirds of the business) at the end of 1985; more than three times that number were listed at the end of 1987. Though the new rules for listing are tougher than most companies were used to (including external auditors and half-yearly accounts), companies raised 65 billion escudos in new issues that year, compared with 29 billion escudos in 1986. Two or three companies are thinking of foreign listings too. These include Sonae, Portugal's largest private holding company, whose plans for a London listing in June may have hit a snag after a public inquiry into a series of controversial share offerings.

The stagnant stockmarkets revived in 1986, when new fiscal incentives encouraged share issues, new banks talked them up and new investment funds were there to buy them. Turnover quadrupled in Lisbon and rose still more in Oporto. In the nine months to mid-October share prices increased fivefold, producing price-earnings ratios of more than 40 for many of them. Foreigners invested several hundred million dollars.

Portugal's investors suffered more than most from the crash, when it came. The authorities retained for three weeks the 5% limit on the amount that a share could move in a day. Share prices inexorably edged down nearly 50% before they changed their minds. As a result, says Mr Alvaro Damasó, president of the Lisbon Stock Exchange, Portuguese shares are still languishing, instead of drifting up with other markets.

That should begin to change soon. Companies are expecting good profits again this year. Though fiscal incentives have been reduced, the market is still attractive to some. In April Citibank's Portuguese subsidiary and Corticeira Amorim, a cork company, came to the market and raised 5 billion escudos between them.

The stock exchanges are modernising too. Daily price fixings are this year becoming twice daily, a step towards continuous prices. Both Oporto and Lisbon have installed new computer systems, and both are streamlining their settlement systems. A new National Council of Stock Exchanges looks after investors' interests.





Broader reforms are being proposed, some in a package of laws due for debate in May. These include tighter listing requirements, insider-trading laws, rules for new instruments and public offers, limited-liability stock-exchange companies and more pension legislation. The new tax reforms may also reduce the current discrimination among different forms of saving. The government is keen on reforming the capital markets partly to create a liquid, efficient and safe market in which to privatise state enterprises. Though it is not yet clear either how or when, some companies are likely to be sold through the stockmarkets this year or early next year.

People criticise the government for lacking a clear overall policy for a financial system that it owns most of. It is true that there has been some backing and filling—for example, on stamp duty (off, on, now soon to be off), on tax incentives, on capital requirements and credit ceilings for foreign banks. But the government is right to fear too much innovation too soon. Foreign financial firms longing to invest more capital in Europe's latest deregulating market would do well to be similarly cautious.

The market is small, it has a lot of banks already and their bubble of protected profitability will soon be pricked by competition.

Aware of their competitive handicaps and above all of their size, Portuguese banks are a bit afraid of being swamped, especially by their Spanish confrères. Not all. "We have to believe in our own capacities," says Mr Alexandre Vaz Pinto, president of Espirito Santo, which has more capacity than most. "But even if it does happen, we have no alternatives."

Revolution it is, as Portugal's financiers endure and even enjoy their mini-bang. But this revolution's odd little lurches and hesitations say a lot about a more generally ambiguous attitude towards change in the country. There is a combination of impetuous approval of what is new and "European", a strong gambling streak, yet considerable and conservative fear of the unknown. If that ambivalence haunts the financial world, the most modern in Portugal, the contrasts are stronger still in industry.

Doing their own thing

Earning a living

UNDERMANAGED, undermarketed, undercapitalised and uncompetitive: that is Portuguese industry to the gloomsters. Yet industrial output has trundled along, growing by more than 3% a year for the past ten years, despite exaggerated economic cycles. Portuguese exports, most of them manufactured, have increased more in the past five years than any other OECD country's. It is impossible to generalise about Portugal's manufacturing companies, so great are the differences between and within industries. One thing is certain: there is more to the place than sardines and port.

Serious manufacturing has had little time to develop in Portugal. Antonio Salazar, inspired by a romantic neo-Ruskinian view of rural society and traditional values, did what he could to keep them down on the farm. Not until the late 1950s did industry get much encouragement, and that of a protected, import-substituted sort. Industrial output then spurred at more than 14% a year for most of the 1960s, from a minuscule base.

Vast swathes of the economy were nationalised after 1974, including virtually all the financial institutions, steel, shipbuilding, chemicals, even beer. The smaller firms were mostly handed back to their owners before long. One boss ousted from a big semi-nationalised industry irreverently jokes that the seizure was the only way to clear out some of Europe's worst managers. But the impact on industry as a whole, coupled with a rotten world economy and sharp boom-and-bust domestic cycles, was to dampen output and investment and exaggerate industrialists' endemic short-term views. A period of sustained growth looks likely now, and businessmen are beginning to think strategically.

The north-south divide runs so deep that there are almost two Portugals. Over two-thirds of all manufacturing companies in 1978 had fewer than ten employees. A lot of these pint-sized operations

are in the north, in the area around Aveiro, Oporto, Braga, which holds about three-quarters of Portugal's industrial firms, perhaps three-fifths of its exports and most of its private sector. This is the centre of the textile and shoe industries, which account for two-fifths of the country's exports, ceramics and wine. Many are owned and run by their founders: "an anarchic lot," says one official who deals with them. Relatively un-unionised, the north votes PSD and CDS most of the time. It is the old home of many colonial settlers, the new home of many *retornados*.

Oporto, Portugal's second biggest city, has an atmosphere all its own. Rainy and bleakly beautiful, Oporto inspires respect rather than affection. The people are different too. They are proud of their city, their food, their clannishness, their football team (champions in 1987) and their practical achievements. The keen commercial bustle of Oporto and its surrounds is a tonic after the wordiness that is all-too-prevalent in Lisbon. Many firms there have been scrambling for several years to reposition themselves in their foreign markets.

Take the textile industry. Manuel Goncalves, the largest firm, launched a bond issue of 2 billion escudos late last year, the largest to date on the domestic market. That firm and Coelima, like others in textiles, have been steadily investing in new equipment. Coelima reckons it is almost as efficient as any other European producer. The industry as a whole is moving away from fabric and into clothing; and within clothing, away from T-shirts that South Korea can make more cheaply and into fashion. The ceramic industry, based around Aveiro and Coimbra, is following much the same path, pouring resources into higher-priced decorative tiles, many of them for export.

The shoe industry is another example. Its 1,000 factories are mainly small, employing 44,500 em-

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ployees in all. It produced last year some 80m pairs of shoes, of which over 56m were exported. Before 1975 it hardly exported at all; last year it earned over 100 billion escudos as Europe's third largest seller of shoes abroad. Producers have set up training centres for their workers and some firms use computer-aided design and manufacturing systems. Their trade association is starting a licensing programme to help standardise better quality, and they are working to diversify sales, over 90% of which now go to Europe.

Shippers of port, for all its staid image, have some new ideas too. Due mainly to price increases, the value of port exports grew one and a half times between 1982 and 1986, and 1987 was better still. Again, port producers fear the concentration in their market: Europe takes almost 97% of the foreign sales. (The biggest buyers are not the British, in fact, but the French, though the Brits are choosier.) But sales to EEC countries may well increase. The Community has no port lake, and a bigger share of Portugal's wine will probably be made into port if a mature market can be expanded. Along with winemakers generally, the industry is involved now in a programme to replant with newer vines. One campaign is to convince the world to drink dry white port, a delicious aperitif.

Yet for each forward-looking entrepreneur there are scores of sweated workshops. Development is not consistent either between or across industries. Much of the textile industry, for instance, is low-tech. Wages averaged 31,000 escudos a month in the clothing and footwear industries last September, three-quarters of the national average and that for a long 45-hour week. In the shoe industry, booming as a whole, three firms are said to be in a state of collapse and lots say that their order books are almost empty. For all this, the number of bankruptcies in Portugal fell by one-quarter in 1987.

For firms in the north, a main impediment is lack of transport and communications. "We are being strangled," laments Mr Luis Todo Bom, executive vice-president of Oporto's Industrial Association and a former secretary of state for industry. Money is being spent, by Lisbon and by Brussels, on new roads and railroads and on telephones, but there is still a long way to go.

The Portuguese government and the EEC are

disposed to spend a whacking sum to help industry and agriculture. Nationally, some 17.8 billion escudos was budgeted in 1988 for "support to the productive sector"—much of it matching funds for likely EEC programmes—with the option of doubling it. The special fund for Portuguese industry agreed in Brussels in February would provide 2 billion escudos over five years. Industry is investing too.

There is not yet a clear consensus as to what sectors Portugal should be spending its own and other people's money to develop. There are those who think that the country's only natural advantages are sun in the south, a handful of medium-grade natural resources like cork and a reasonably skilled low-wage labour force. The new labour-law reforms will lessen the restrictions on hiring and firing which have for some employers outweighed the advantage of low pay. Their strategy is to plug away at the existing range of mainly low-tech exports until (if) wages rise too much, then let services, especially tourism, pick up the slack. That is short-sighted, say others like Mr Jose Viana Baptista, president of the state-owned communications companies, CTT and TLP. "We need to specialise intelligently. We need more value-added."

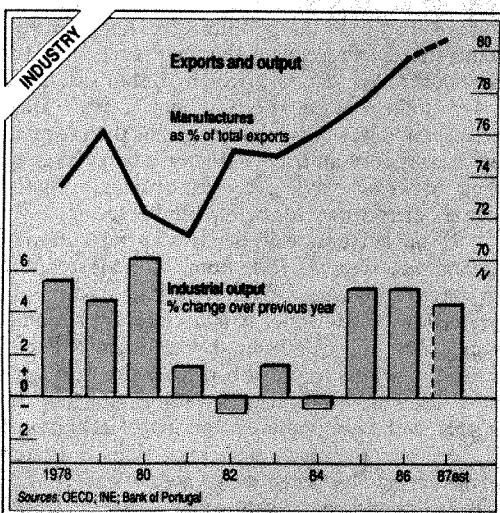
The debate between services and industry is not simple. As Mr Luis Mira Amaral, the minister for industry and energy, points out, it is difficult to promote a flourishing service industry without a manufacturing sector to start with: Japan's financial growth followed its industrial development. But whatever the eventual mix of light manufacturing, agro-industry, perhaps a little tech, services will play a big role. None more than tourism.

Portugal lives off its charm

Tourism is no sideshow in Portugal. It is as important as agriculture and fishing in GDP, and it paid last year for 45% of the visible trade deficit. The number of visits by foreigners—more than half of them Spaniards—to Portugal increased by 23% last year, and about 15% in the first three months of 1988. Receipts in 1987 rose by around 30% to something near \$2 billion. Though the south and Madeira, plus Lisbon and Oporto, are the travellers' main destinations, the interior has beautiful sites too: room occupancy in Minho, in the north, has been increasing recently. Development in Madeira and in Minho is controlled and orderly. The problems are where the biggest bulk of people, mainly British, flock: the Algarve.

Developers in the Algarve say that, where political pressures matter, it takes months and sometimes quite a lot of escudos to get even preliminary approval from the local councils to build. When permission is granted, the services provided are often overstretched and inadequate. Unlicensed illegal hotels and flophouses outnumber legal ones by bed capacity. If the muddle continues, the result, many fear, will be a shambolic tourism that will not attract either a few big-spenders or a mass of low ones.

The government wants to encourage higher-quality tourism, not another Benidorm. In April an interdepartmental group was formed from ministries responsible for everything from the environment to transport. The bureaucrats will report on how to keep the Algarve the fantastic resource it





still is. They will then prod and help municipalities prepare local development plans. In the meantime, they plan first to persuade, then punish, those who run illegal hostels.

It will be the private sector, however, that mainly shapes the industry. One Spaniard who finds sites for development says that Portugal's tourism would take off if it just had a jet-set centre like Marbella, a few sheikhs' yachts and a rent-a-duchess or two. But the Portuguese go up-market discreetly. The developers, including Britain's Bovis, of Prainha in the Algarve, where villas can sell for £125,000, have another more gorgeous £30m project in mind nearby. Secluded houses in this 970-hectare park—with stables and golf course on tap—will be marketed at a cool £500,000 or £1m each.

Slimming the state sector

The one thing most politicians and economists agree on is that heavy industry has little place in Portugal's future. Some state-owned industries, like the breweries, tobacco monopoly, cement and pulp producers, would have perfectly reasonable prospects if someone else owned them. Others—no-hopers like steel and ships and chemicals concentrated in the area near Lisbon and Setubal—have long been a drag on public finances and talent.

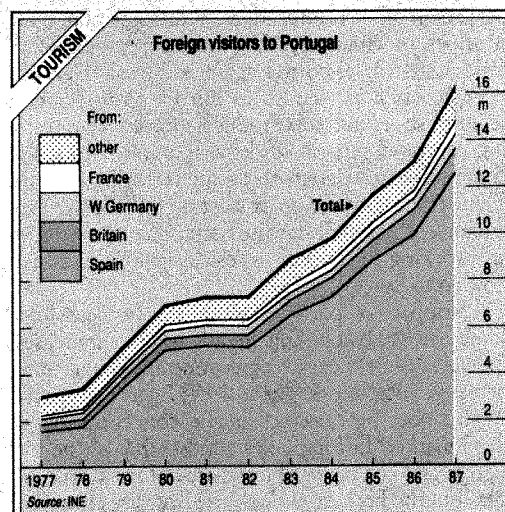
The tentacles of public ownership are hard to untangle. Some 50 non-financial enterprises are entirely state-owned and belong to a group known as EPNF. Another 70 enterprises in which the state owns anywhere from 2% to 100% of the equity are controlled by a national holding company (IPE). Some government agencies make or sell goods and services, which go with nationalised enterprises for national-accounts purposes (arms, agriculture, infrastructure), though some are being phased out. A lot of EPNF subsidiaries operate under private law.

Looking just at the EPNF group, public enterprises' share of national value-added was 15% in 1986, on figures from the OECD's new report on Portugal, up from 10% in 1977. Their share of fixed investment, though, had fallen to 14½% from 20% that year, while their proportion of employment had fallen to 4½% in 1986 from 5¼% in 1982.

Portugal is sorting out its nationalised industries in different ways. It has until 1990 to meet the EEC's steel industry quotas and fines. At least 67 billion escudos is being spent restructuring and streamlining the national steel corporation, Siderurgia Nacional. The petrol-retailing monopoly has to be disbanded to satisfy EEC competition rules.

Setenave, the state-owned shipbuilding and repair company, is likely to be split up, shedding its shipbuilding to a foreign firm, its repair yard to minority state-owned Lisnave, and its debts to the state. Raw deal, says Lisnave, which has scrambled back almost into prosperity and wants its 40 billion escudos of debt rescheduled too.

Portugal's public telecommunications enterprises (CTT and TLP), and the 52% state-owned Companhia Portuguesa Radio Marconi, which provides marine cable and satellite transmission, reckon local and foreign competition is coming soon, at least in value-added services like national paging, electronic mail and enhanced data transmission. The telephone companies have been



modernising their network; CTT plans to spend \$1 billion on investment in the three years to 1989. Meanwhile, they are stimulating joint ventures between technology-rich foreign suppliers and Portuguese ones. They have signed two 8 billion escudos deals for switching equipment, one with ITT and one with Siemens, to manufacture digital-switching equipment in Portugal with local partners and to set up software houses.

Selling the silver

Privatisation is the ultimate solution, to pay off public debt and improve the management of many companies. It was one of Mr Cavaco Silva's strongest promises during his campaign. Yet privatisation has so far proved a lot less rapid than expected.

To get around the constitutional prohibition on selling nationalised assets, the government has had a bill passed to allow the sale of stakes of up to 49%. Small shareholders and company employees are to get priority for at least 20% of the issue of new shares; no institution may purchase more than 10% of them and foreign groups and institutions may not buy more than 10% of the issue altogether.

The prime minister says he will sell one or maybe two enterprises before the end of 1988. But foreign merchant bankers expecting a flood of privatisation business against which to amortise their already lengthy stays at Lisbon's Ritz or Sheraton are likely to be disappointed. It is not clear who wants shares in a company that may remain for ever state-controlled. Share prices in Lisbon are 55% lower than before the October crash, when privatisation was being talked up. For the moment, officials are content to let would-be advisers present their schemes, while long-expropriated original shareholders agitate for better compensation.

"What Portugal really needs is a privatisation of mentalities," says Mr Todo Bom, a former secretary of state for industry. "We have a long tradition of protection by the state. It is a cultural phenomenon." Over and over again, the criticism of Portuguese industry is to do with neither the workforce nor the natural resources nor the capital but the quality, with honourable exceptions, of its bosses. It is specifically their lack of strategic skills and often of marketing experience, aggravated in state companies by low and unmotivating pay. "The main prob-

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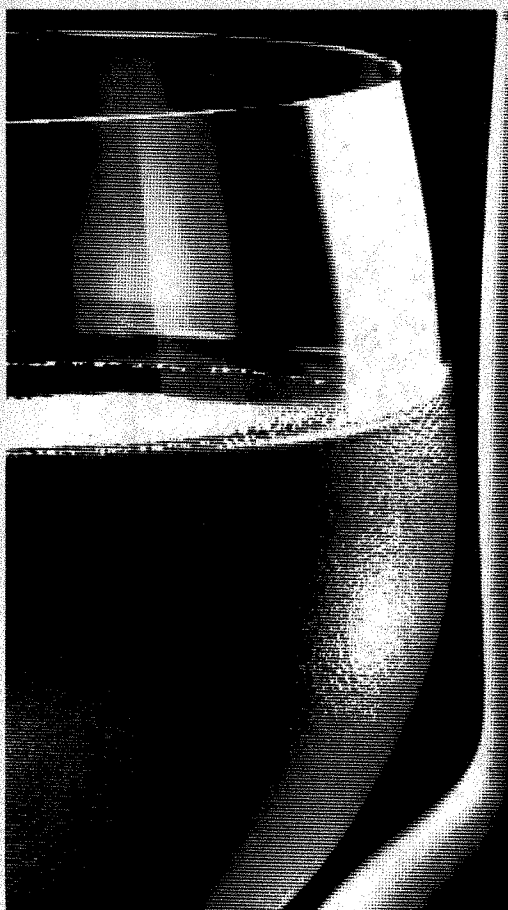
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December 1987

(Escudos millions)	1985	1986	1987
Total Net Assets	19,016	25,145	39,481
Total Loans	8,390	12,707	25,266
Capital Funds	1,909	2,778	9,506
* Net Income	453	868	1,502
Return on Net Av. Assets	3.62%	3.93%	4.65%
Return on Av. Equity	26.9%	37.1%	40.9%
* After taxes and allocations to provisions.			

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lem in Portugal is management and organisation," says Mr Mira Amaral.

Because Portugal came late to the postwar wave of American investment in Europe, it does not have the generation of managers trained by Proctor & Gamble or IBM that France, for instance, has. Postgraduate courses in business management are only just beginning. The first, at Lisbon's New Univer-

sity, started in 1980 and has produced some 200 graduates. Another, at Oporto University, will start this year. A management mystique is gradually catching on—even among the surprising number of women who are to be found in prominent positions in Portugal. A new Portuguese Association of Business Women held its first meeting six months ago, to a packed house.



Farmers have a long row to hoe

More do less

OVER one-fifth of Portuguese workers still work in agriculture, more than in any other EEC country except Greece. Yet Portugal imports close to half the food it eats. Food and drink account for less than one-tenth of total exports and a lot of that is (very nice) booze. Farming, plus forestry and fishing, contributes only 9% to the country's GDP. In efficient Britain, the farming 2.6% of the workforce produce 1.5% of GDP; in less efficient Spain, 16% produce 6%.

Portugal's farms have been Europe's least productive for 25 years or more. Some of the problems are the familiar Iberian ones. Most of the farms of the north and centre are tiny: almost half the farms are of one hectare or less and have between them less than 5% of the total land. The *latifundia* of the south, mainly in Alentejo and Ribatejo, are huge: less than 1% of all farms that have more than 100 hectares have half the land. Most of the northern farms are too tiny and scattered to modernise effectively. Landholding in the south, usually unproductive to begin with, has been complicated by the expropriations of 1974-75.

The entrepreneurial structure has also long been skewed against productivity, as Professor Fernando Brito Soares of Lisbon's New University points out. Many are subsistence farms only, consuming over half of what they produce and many are run by tenant farmers. In 1979 almost two-thirds of all farmers were 55 years old or more, and almost one-third were illiterate.

Small wonder that there has been little innovation. Farmers' use of fertiliser in 1985 was not significantly higher than in 1971. Tractor sales have increased enormously, but Portuguese farmers have fewer than the EEC average. Though rainfall is variable, there is little irrigated land. A hectare in Portugal produces 45% of the value-added that an average hectare in the rest of the EEC (excluding Spain) does, and an hour of Portuguese labour 33%.

Though cereal harvests have risen recently, Portuguese yields are still one-quarter to one-third of the EEC average and two-thirds of those of Spain and Greece. Productivity in wine and milk is about half that of the EEC. The production of much fruit (apples, pears and peaches, for example) has declined recently, though oranges are on the increase.

More grows in Portugal than just food, of course. There is a big forestry products industry: for instance, eucalyptus grows in Portugal faster than in most of the rest of Europe. Alentejo is especially suited to cork oak, and Portugal provides 80% of what the world uses.

What food Portugal does manage to grow it has

trouble selling. Farmers tend to plant what they like, not what buyers want. Marketing organisations are thin on the ground. Take strawberries. Plenty are grown in the Algarve, and some are sold outside the region. In Lisbon, however, diners are still more likely to sit down to Spanish berries than Portuguese ones.

To conclude this sorry but familiar tale of southern European agriculture, Portugal's only really successful edible exports have so far been port, processed tomatoes and tinned sardines. Its climate and location make it an obvious spot to grow all sorts of early fruit and vegetables for northern Europe. In the autonomous regions of Madeira and the Azores, too, certain tropical crops like bananas and tea are grown. Now things are changing.

Yes, Virginia, there is some good news

In the Algarve, citrus farming is expanding rapidly and the fruit rivals anything Spain can produce. There and farther north, exotic fruits like kiwis, strawberries and avocados are being grown and even exported. Iceberg lettuce, watercress and chrysanthemum cuttings are making their way to Britain. There has been an increase in farmers' associations which should help co-ordinate planting and the greater use of common facilities.

Much of the innovation is due to foreigners—British, Dutch, Danes and Swiss—who have gone in quietly, bought land, invested in equipment and decent seeds and plants, and prospered. But the Portuguese are investing more too. Some large non-agricultural firms and holding companies are talking of investing in agriculture. Much of the investment, both official and private, is going to Ribatejo and Alentejo, where landholdings are a reasonable size. It also has the lion's share of irrigated land.

Portugal has three agricultural obstacles to overcome as it becomes part of the Community. The first is that the technical level of its farming is so much lower than the rest of the EEC. The second is that its agricultural prices are so much higher. The third, longer-term, is what to do with the mass of underemployed farm workers as its farms are forced to become more efficient.

In the first five-year phase of EEC transition, Portugal is supposed to get rid of old state regulatory bodies and set up new EEC-style intervention agencies, develop marketing organisations, free prices, and ditch incompatible subsidies as much as possible. In the second, EEC prices and tariffs are to be phased in gradually until 1996-97.

Community and other state aids will do something about the first problem, the need for technical



modernisation. Portugal is to get 700m ecus over ten years from Brussels to reorganise its agriculture. More than 8,000 Brussels-linked projects were approved in 1987, with investment totalling 42.5 billion escudos. Government and EEC subsidies were 27.4 billion escudos. The money is being spent on rural roads, irrigation, electrification, technical training and commercial marketing-structures. In 1988 the increase in investment in infrastructure is estimated at 30%.

The hardest row of all

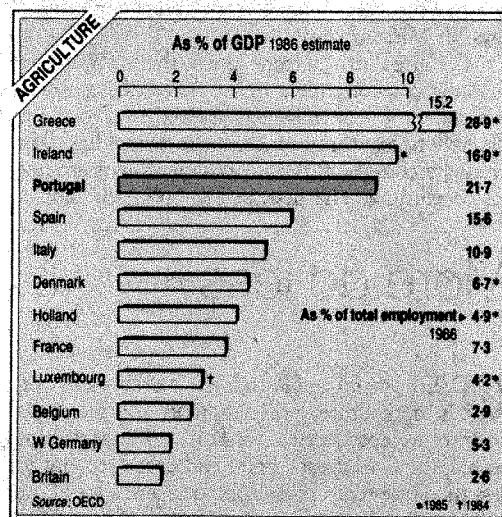
Prices are the toughest part. On accession, Portugal's wheat price was 70% higher than the EEC's. Maize was 60% higher. Yet Portuguese farmers are poor. Their average incomes in 1980 were only one-third that of the rest of the economy, and they had shrunk still more by 1985, according to Mr Francisco Avillez, who teaches economics at the Instituto Superior de Agronomia of Lisbon's Technical University. Now prices are coming down, too fast for his and others' liking. The price of wheat was 5% lower, in real terms, at the end of 1987, than two years earlier; maize was 14% lower; and milk 10%, all on the mildest measure of inflation. Yet the treaty of accession allowed Portugal at the least to maintain the real value of such prices.

"It is a matter of prudence," says Mr Arlindo Marques Cunha, secretary of state for agriculture. "We could be popular politically if we kept prices as high as possible, but in five years' time the adjustment would be very severe." This year's prices are likely, nonetheless, to be a bit higher in escudos.

But the Brussels summit has given things a new twist. When Portugal undertook to lower its prices to EEC levels by 1996, it was assumed that the latter would rise somewhat by then. So far they have not, and cereal prices are likely to fall. That means that Portugal's have further to drop. The EEC has recognised the specific difficulties of Portuguese agriculture and agreed to give it five years more to adjust its cereal prices.

The EEC has also accepted the possibility of co-financing, if necessary, a special producer subsidy after the first phase ends, letting Portugal off production restrictions and land set-aside programmes. Along with other bits and bobs, Portugal also wants Brussels to agree to refinance its agricultural development fund when it runs out, not just to discuss it, in ten years' time. And it wants an EEC policy on cork and forestry.

It looks as if Portuguese agriculture will not be joining the EEC fully until the twenty-first century. For Mr Avillez, that is a good thing. "Farmers need time to adjust and profit to invest. Younger farmers know that they must change or specialise. They



don't know what their options are. There needs to be more research to find out."

Europe's California?

Though most agree on the problems, few do on the solutions. It is not clear where Portugal will be truly competitive internationally, still less how to handle the social consequences of abandoning its weakest points.

The small farms in the poor north have the fewest comparative advantages. The EEC has too much of the beef and milk they go in for. But there have been improvements in dairy farming over the past 15 years. Portugal's farmers are rather good at sheep, which the Community has less of, and better at some sorts of wine, especially semi-sparkling white and, of course, port.

The irrigated bits of the Alentejo and Algarve, Ribatejo and the valley of the Tagus river have plenty of prospects. Some farms are efficient producers of maize and many are of rice, which Portugal exports. Much of the new fruit and vegetable farming is in these regions.

Horticulture is, in fact, one obvious answer for Portugal. It needs investment, though, and above all, selling. Spain is going in for it with much the same advantages as Portugal and is better organised at commercial marketing. Pascual Hermanos, for instance, a Spanish agro-food company, is one of Europe's largest. It has no Portuguese counterpart.

In the ever-longer run, Portuguese agriculture will become more streamlined than it is today. More investment will go into agro-industrial processing. The government's job is to help those who can compete and minimise dislocations for those who cannot. Both will need it.

Coming home

On the edge of Europe, with much to take and give

"THE main benefit for Portugal in joining Europe is not the structural funds, or access to a market of 320m consumers, but the sheer impetus to make long overdue changes at home," says a foreign diplomat. Being competitively *communaute* will put the squeeze mainly on agriculture, with

spillover effects into other parts of the economy. Farms will shed jobs which industry (probably job-shedding itself) and services like tourism will have to pick up. To expand, businesses need not just better management and marketing, but more and cheaper capital. The financial system must adapt, and is

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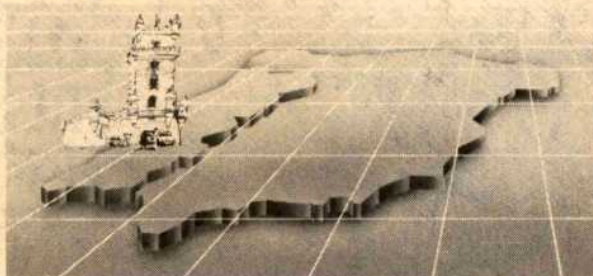
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adapting, to provide that capital when the flow of Brussels money slackens. Inevitably, however, unemployment will rise. Success in retraining and containing unemployment will in large measure determine how smooth a ride Portugal's democrats have towards the end of the century.

Portugal's role in the world is changing too. Emotional and political ties to its old African colonies remain strong. Portugal's government, which supports the MPLA, is willing to play a role in sorting out Angola's problems, for instance. But economic links are a shadow of their former self. Trade with Angola and Mozambique, a big share of mainland Portugal's total in the 1960s, is now 1% of it or less. Portugal may speak for the Lomé countries with particular warmth, but its face is now turned towards Europe.

Within Europe, Portugal's perspective is bound to change. Britain's oldest ally, pretty jaundiced anyway since 1961 when Britain let India take Portuguese Goa, will have less to do with it and more to do with their old common enemy, Spain. Though the British will remain big investors in Portugal, at least while tourism is developing, Spain's share is rising rapidly. Britain was once so dominant a trading partner that Portugal joined EFTA when it did, but trade with Spain now almost equals trade with Britain. Spanish tourists outnumber British in Portugal almost 12 to 1 (though the Spaniards stay one-third as long). Most important, Portugal's interests within the EEC are more apt to converge with Spain's than with Britain's, as, for instance, in the February battle over structural funds. Though the increasingly English-speaking Portuguese remain anglophile at heart, the relationship with Spain is the one that matters now.

Portugal's tautly ascetic prime minister and Spain's casually charming one, both southerners, spent Easter weekend together *en famille* in Spain's Donana park. To hear their leaders tell it, Spain and Portugal are on the brink of a new golden age of Iberian solidarity and co-operation. Outsiders are

certainly prepared to believe it. "There is an increased willingness by foreigners to treat Iberia as a unit now," says Mr Carlos Ribeiro Ferreira, the Portuguese head of Hispano Americano's new investment society in Lisbon.

Yet Portugal and Spain have in the past turned their backs on each other, and their complicated non-relationship will not change overnight. For all their common Iberian heritage (commoner in Galicia, the north-west corner of Spain, whose language, climate and culture are most similar to Portugal's), the countries are remarkably unlike.

Their languages sound more different than they look. Not for the Portuguese Madrid's midnight meals and all-night *paseos*; Lisbon lives a more closed, domestic—in fact, more English—life. Many Portuguese find the Spanish hard and assertive; Spaniards often think the Portuguese lethargic and unself-confident.

The main difference is in their standard of living, though this was not so 30 years ago. Portugal's vaunted openness to foreign influences proved less modernising than autarkic Spain's sheer economic oomph. Spain today belongs to Europe, albeit to its second team; for all its splendid history and culture and recent progress, there is still something third-world about Portugal.

Many Portuguese envy and admire Spain for its dynamism, that explosion of vitality as you cross the frontier from Portugal into Spain, and hope unworriedly to achieve some of the same through partnership. Others fear that they will be swamped by their more aggressive and far larger neighbours. One still hears the old saw: *De Espanha ni bom vento ni bom casamento* (From Spain, neither good wind nor good wedding).

"We need to be proud of our history, to know who we are, where we come from, where we want to go," says Mr Roberto Carneiro, Portugal's education minister. History prompts some encouraging reflections. Portugal was Spain's for 60 years, until 1640, but has managed to resist ever since then the centripetal force that drew the rest of the Iberian regions towards Castille's centre. Its people pride themselves on never having been conquered by Napoleon, who made mincemeat out of much of the rest of the EEC. In recent times, it has consolidated its new democracy amazingly quickly, bringing order out of chaos in surely record time. All reason to think that consolidating the economy within Europe can and will succeed.

For it to do so, the Portuguese need to do two things that do not come naturally to an individualistic and romantic people: pull together, and set specific priorities. Only the rich can afford Eurowaffle. The northern potato-growers who dominate the Community now have a lot to gain culturally from their new, small member, though perhaps they do not realise it yet. A much-read poem by Fernando Pessoa written over 50 years ago yearned for the day when Portugal would rally to its destiny: *quando é a hora? Quando?* Yearning is up; the hour is now.



Eurobound



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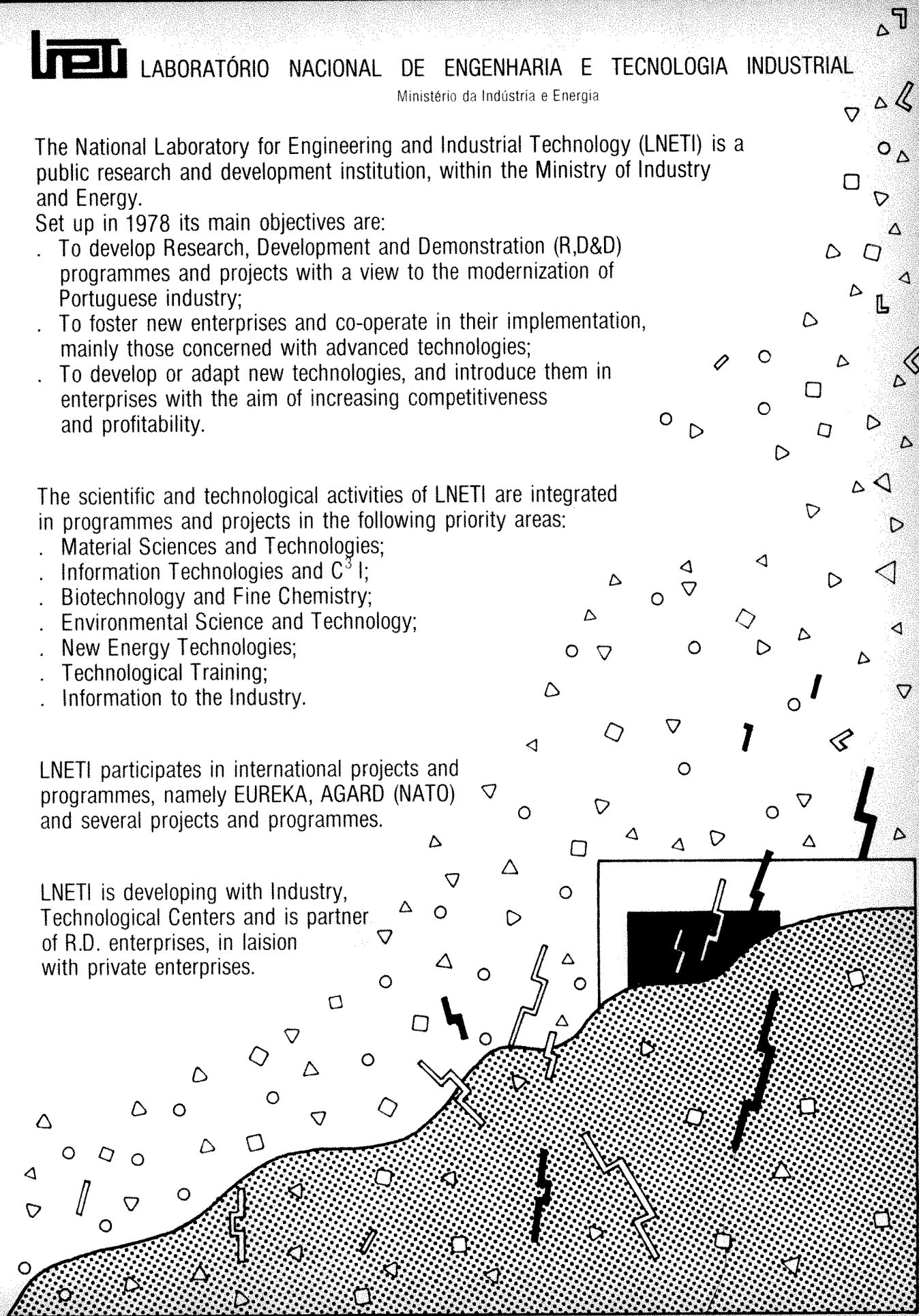
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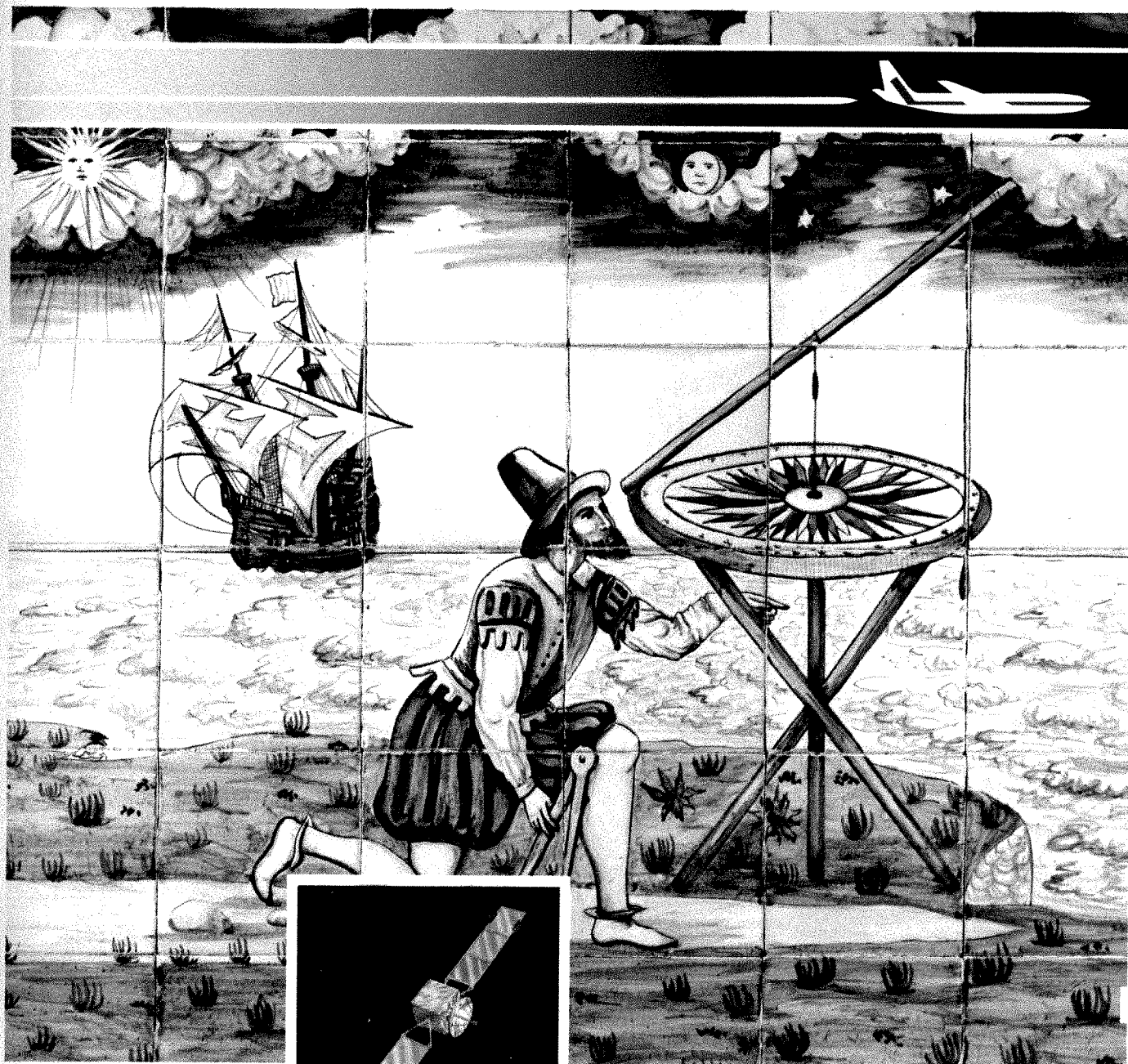
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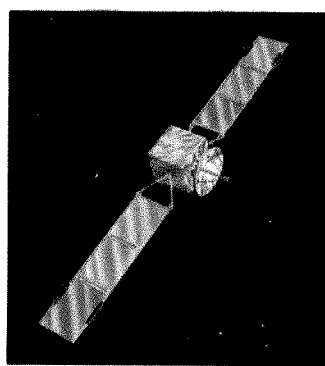
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BRITAIN

Labour's draft for disunity

INSIDE the Labour party there is a party of government struggling to emerge. But it is a hard struggle. That much is obvious from the heated discussion this week by Labour's National Executive Committee (NEC) of the draft reports of the party's seven policy-review groups.

Although Mr Neil Kinnock, the Labour leader, has easily persuaded the NEC to publish the seven reports next month, the battle is only beginning. It is likely to continue throughout the summer and to be the main topic of Labour's annual conference at Blackpool in October. The attack on the policies was led by Mr Tony Benn, who is challenging Mr Kinnock for leadership of the Labour party. He decried the drafts as

superficial and shallow in their analysis, extremely weak and vague in their remedies. They point unmistakably towards the acceptance of many of the changes made by the Tories since they have been in power...

Mr Benn can say that again, and he often will. He has put his finger on precisely the snags that arise as a result of Mr Kinnock's tactics.

These policy groups, which were set up last year—with their membership carefully balanced between the NEC, the parliamentary party and the trade unions—were never intended to produce firm policies for this year's conference. Their aim was to guide

the mood of the Labour party towards implementing the principles drafted earlier this year by Mr Kinnock and his deputy, Mr Roy Hattersley. Their principles were said to be those of democratic socialism, two words which reveal Mr Kinnock's main dilemma.

Should he continue to present Labour as a socialist party? Or should he use Mr Benn's challenge to split the hard left from the party, and to present Labour as a post-socialist party? The middle ground of British politics is at present unoccupied by any credible political party. It is a ground which many traditional Labour supporters would gladly occupy if it were the path to power.

Centrist stuff

There are three main reports: on the economy, on employment and on tax. The first, on the **economy**, was drawn up by a group led by Mr Bryan Gould, shadow spokesman for trade and industry. It has been attacked by Mr Eric Heffer, who is challenging Mr Hattersley for the deputy leadership. "It is basically non-socialist and could easily have been drawn up by a committee headed by Dr David Owen... it is a document even some Tories could accept. I am sure Ted Heath would find little wrong with it."

Entitled "A productive and competitive economy", the central theme of this report is the supposed need for a medium-term industrial strategy in which "government agencies and local authorities work in partnership with firms, the CBI, trade associations and chambers of commerce so that the process of policy-making and industrial development is one of concerted action." This is not so different from the sort of thing Mr Michael Heseltine has recently been talking about. Its main difference from the tripartite (government, CBI and TUC) system of both the first Wilson and only Heath government is that it appears to give no explicit role to the trade unions; indeed, it does not even mention them.

Mr Heffer is particularly cross that the group turns its back on traditional nationalisation, even for utilities. It merely states that "they cannot be run solely on the basis of private profit", and proposes a galaxy of devices to improve their management. They include a "public interest company with statutory responsibility to meet

the needs of consumers and the national interest... strengthened regulatory authorities... the use of majority and even minority shareholdings, special shares and conversion of shares into non-voting hands... municipal enterprises, workers' collective share schemes, worker co-operatives and new roles for pension funds."

The report on **employment** discusses Labour's proposals for reversing Tory industrial-relations legislation. It is the product of a group led by two left-wingers—the shadow employment spokesman, Mr Michael Meacher, and Mr Eddie Haigh of the transport workers' union—and is therefore likely to annoy fewer dignitaries in the party, but annoy more voters instead. Although Labour would keep secret ballots, other Tory laws on trade unions would go: legal protection from union discipline for those who refuse to strike after a ballot and the ban on secondary picketing among them.

The group reporting on **tax**, led by the shadow chancellor, Mr John Smith, proposes a starting rate of tax lower than the present 25% and a top rate higher than the present 40%, but not substantially higher than that in other European countries—perhaps no more than 60%. There would, however, be heavier taxes on capital and an attack on tax perks, tax havens and the business-expansion scheme.

Together, the reports assume that an incoming Labour government in the 1990s would be faced with severe economic constraints, a balance-of-payments crisis, over 2m unemployed, a cruelly unequal society with one in three of the population on or below the poverty line, and a benefits system unable to cope. There are problems with



Kinnock fudges the centre



Benn stays coherent on the left

this gloomy approach.

According to a recent MORI poll, two out of three voters think that Mrs Margaret Thatcher has done a good job on the economy, so the gloom is rather insulting to them. Last year's election post mortem showed that doubts about Labour's ability to run the economy had been a big vote-

loser. Mr Kinnock and Mr Hattersley forecast an economic crisis immediately after the 1987 election. The electorate did not believe them then, and the crisis has not happened so far. Even if voters could be persuaded that the outlook for the 1990s is gloomy, this week's unstimulating platitudes might not cause them to turn to Labour to see them

through.

The party is still split into an uneasy silence on defence. Mr Kinnock cares passionately about nuclear disarmament. While he leads the Labour party, it is hard to conceive of him admitting any circumstances in which a Labour government could threaten to use Britain's independent nuclear deter-

The voyage from the Windrush

In June 1948 the first big group of West Indian immigrants to Britain arrived, full of hope. The disappointment they suffered has shaped the attitudes and behaviour of their children and grandchildren

WHEN the ss Empire Windrush docked at Tilbury 40 years ago, the 500 Jamaicans aboard did not see themselves as impoverished third-world adventurers. Typically skilled or white-collar workers who had served in the British forces during the war, the young men who walked off the ship in double-breasted suits and trilby hats took seriously the British citizenship granted to them and other colonial citizens by the 1948 Nationality Act. Along with the 125,000 other West Indian settlers who followed them over the next ten years, they expected to put their skills to better use in labour-hungry Britain than they could back in the depressed Caribbean. Things did not turn out that way.

The children and grandchildren of those early settlers are today twice as likely to be unemployed as white Britons; less than half as likely to pass five O-levels; more likely to be in prison than any other ethnic group. On all counts the descendants of West Indians have done worse than the descendants of the Indians and Pakistanis who followed them—even though the West Indians had the advantages of a common language and a common religion. To some extent, the reasons lie in the culture the new arrivals brought with them; to some extent, in their bruising experiences in the 1950s.

The new settlers were naively unprepared for the racial prejudice that they were to encounter in a country they had been taught to regard as their motherland. But in 1948 only half of Britain's white population had ever met a black person, and most had been taught to regard them as uncivilized heathens. The British since then may not have become less prejudiced, but they have learnt to disguise their feelings better: more recent immigrants—from black Africa, for instance—have had much less overt discrimination to contend with.

Those early settlers found it easy enough to get work. Britain's factories,

hospitals, railways and buses were all short of willing hands. By 1956 London Transport was recruiting staff in Barbados, and within 12 years had taken on nearly 4,000 workers from there. A junior health minister called Mr Enoch Powell welcomed West Indian nurses to the country. But the newcomers soon found that while they were welcome to empty bedpans, clean floors and work unsocial hours as bus-conductors, higher-status jobs were reserved for whites. In the late 1950s over half of London's West Indian men had jobs of lower status than their skills and experience equipped them for.

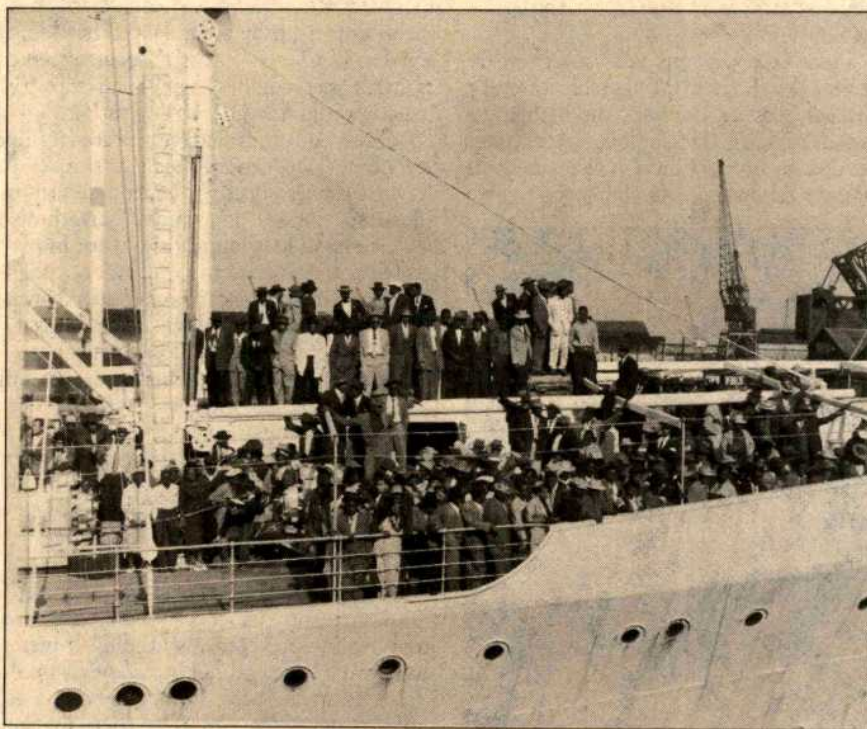
The prejudice which confined the newcomers to low-skilled jobs also drove them into the worst council housing. The first settlers found it hard to get lodgings (landlords said they were not prejudiced, but

the neighbours always were). Crammed into the worst private slums, they willingly moved out into the recently built high-rise council estates.

The children of the earlier immigrants readily picked up the habits of dependency of the poorer members of the British working class, among whom they found themselves:

● **At work**, West Indians have always been heavily dependent on being employed by others, and have traditionally relied on manual jobs in manufacturing and the public sector. They join trade unions more than whites, and have a keen sense of their employment rights. Their loyalty to trade unions and the Labour party persists, despite Labour's blatant failure to reciprocate.

By contrast the Asian immigrants, who began to arrive after the West Indians, expected to make their own employment. A 1982 survey estimated that nearly a fifth of Asian men with jobs were self-employed; the equivalent figure for West Indians is probably well under a tenth. Asian entrepreneurs have concentrated on one of the fastest growth industries, retailing. Those



Docking to disappointment

rent. As a result, the independent deterrent would in practice be decommissioned. The party triumph which Mr Kinnock enjoyed at Blackpool in 1986, when he made this clear, led to electoral defeat in 1987. Public opinion has hardly changed since then. Two out of three electors are still opposed to unilateral nuclear disarmament. Not even a major-

West Indians who have set up their own businesses have often concentrated on catering mainly for their own community: Caribbean travel agents in London's Hackney, hairdressers in Brixton. That means most will stay small. When the *Sun* newspaper recently went in search of "the blacks who made it big", its typical "tycoon" employed 50 staff to make Afro-Caribbean cosmetics.

● **For housing,** West Indians have become strongly dependent on the public sector. In 1982, when the Policy Studies Institute surveyed black and white Britain*, 46% had rented council houses and flats, compared with 30% of whites; in Inner London 59% of West Indians were council tenants. Since then, the gap may have widened: the council houses that have been sold have been mainly family homes in pleasant suburbs, where few blacks live.

Overtaken

Prejudice, past and present, is not explanation enough. The pattern of many West Indian lives fits their children badly to overcome discrimination. In particular, Caribbean-born women have far and away the highest illegitimacy rate of any group in the country: 48% of their babies are born out of wedlock, compared with 23% of the babies of British-born mothers. The proportion is still rising (back in 1971 it was only 36%) although not as fast as among British-born women. Children in

West Indies frequently do not live with their real fathers, but men willingly support the children of the women they are currently living with. In Britain job prospects for women are better, and for men worse. Black British mothers often end up raising their children alone.

A great many of today's black youngsters are therefore being brought up by a lone mother, either on welfare or in a low-paid job, living in a tower block. With no family pressure to stay on at school, they leave with poor qualifications and find it takes them twice as many job applications as their white mates to get a job. To break that cycle needs more positive efforts by British employers. But the fulfilment of the promise of the *Windrush* will require an effort by blacks too.

*Black and White Britain, the third PSI survey", Heinemann, £8.95.

ity of Labour voters supports the policy. This is presumably why Mr Gerald Kaufman, shadow foreign secretary and the joint convenor of Labour's international and defence policy group, can say only that "the fast moving developments in world events following US-Soviet summits will have their effect on our review of how Labour's non-nuclear defence policy can meet the challenge of the 1990s".

The careful fudging of the policy reviews means that they should pass easily through Labour's 1988 conference. When their faint outlines become firmer, more disagreements will surface. The left has none of these problems of coherence and consistency. Mr Benn plans to present his own policies at a weekend conference in his Chesterfield constituency on June 11th. Nearly 15% of present Labour MPs support Mr Benn's policies, although they will not all vote for him in the autumn leadership election. The louder ring the cheers for Mr Benn, the more votes will be lost in the country. Once Mr Benn has been soundly beaten, Labour's main hope seems to be that the British electorate might swing to fudge.

Politics and morality

Caesar talks back

FOR 20 centuries rulers have cited the Bible to justify everything from war, torture and burning witches to Marxism, taxes and abstinence. Now it is the turn of money-making. Goaded by the Labour party's claims, particularly during the last general election, that Conservative policies were immoral, the prime minister has set out her own articles of faith. Recourse to moral justification looks like becoming a hallmark of her third-term government.

Mrs Thatcher described her credo in a speech to the Church of Scotland's general assembly in Edinburgh: the sermon on the Mound. She emphasised the virtues of self-reliance. She also stressed that the creation of wealth was not wrong; only the love of money for its own sake. "The spiritual dimension," said Mrs Thatcher, "comes in deciding what one does with the wealth." She was quickly joined by Mr Douglas Hurd, the home secretary, who concurred that "individualism is not just a narrow or a selfish thing." People should be active citizens, involved in their local community.

Her Scottish sermon was followed by a harder-hitting speech to the Conservative women's conference, in which she attacked Labour for its "desperate" attempts to portray Britain as a greedy society. Her critics say this is because Labour has hit a raw nerve: it was awkward that a tax-cutting

budget which mainly benefited the rich should coincide with the implementation of welfare-benefit changes which reduced the incomes of some of the poor.

In the battle for the moral high ground, Mrs Thatcher has some advantages over Mr Neil Kinnock. She began her Scottish speech with the words, "Speaking personally as a Christian", a line the Labour leader would never comfortably use. She is fascinated by theology, and well-versed in Christian teaching: when drafting a speech, her instinct is often to reach for a parable or a biblical phrase. The sceptical Scots at the general assembly might not agree with her interpretation of the scriptures—"simplistic" and "selective" were common complaints—but they appreciated her courage in standing before them and expounding her personal beliefs.

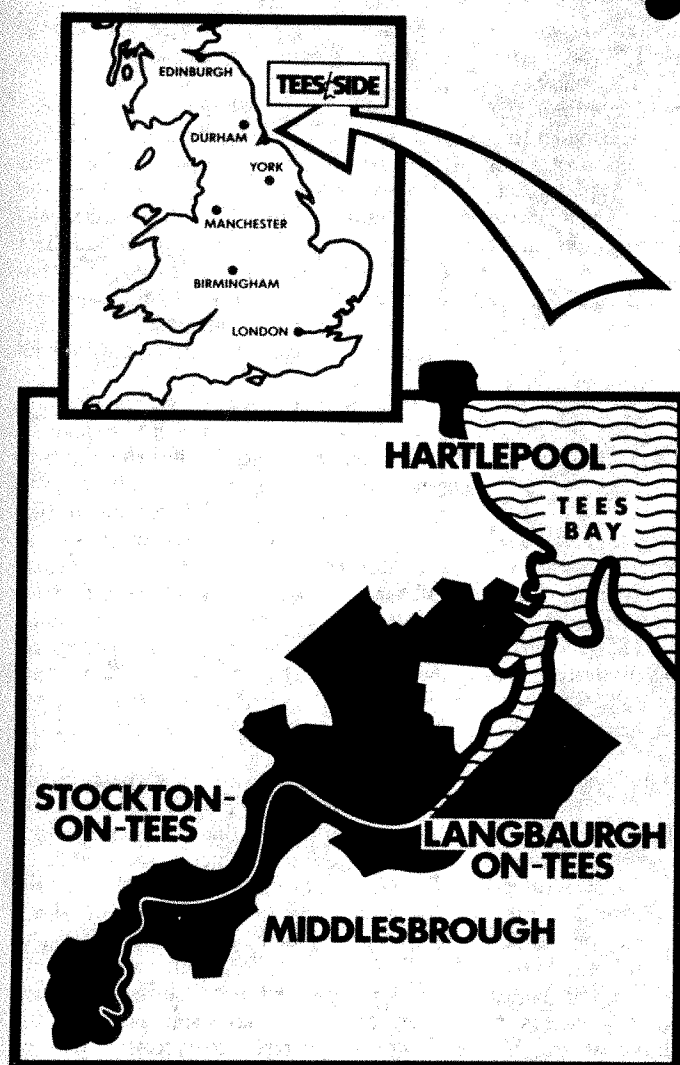
Personal responsibility is now to be the moral theme of most new policies. Having given people more freedom—to buy their own houses, negotiate their own wages, and make money without union restrictions—Mrs Thatcher feels the need to remind them of the responsibilities which go with that freedom. This is a reversal of the government's first two terms of office, during which it was largely agnostic about individual morality.

She quoted with approval the words of St Paul: "If a man will not work he shall not eat." That theme lies behind the desire to wean people off dependency and into jobs, and the wish to stop people relying on their local authority for such necessities as housing and education. Government figures published last week showed the dependency culture still rampant: the number of families under pension age drawing supplementary and housing benefits rose by 84% between 1981 and 1985, thanks mainly to an increase in the numbers of single parents and the unemployed.

Mrs Thatcher would like the churches to join her in putting more emphasis on self-reliance and personal morality, and to carp less about the government's social policies. The Church of England, once seen as "the Tory party at prayer", is often openly critical of the government. In 1985, according to Gallup, 57% of clergymen expressing an opinion supported the SDP-Liberal Alliance. Even after that party's split last year, the clergy still preferred it to its rivals, according to another Gallup poll taken in December.

That is more a reflection of the radicalism of the government's policies than the radicalism of the Church. The formative years in the lives of most Anglican bishops were spent in the heyday of the welfare state and the National Health Service, when the state was taking over from the churches and other voluntary organisations the role of caring for the poor, the old and the sick. Bishops are baffled by a government that seems to want to dismantle much of that es-

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teemed edifice. And the Bible, they might reasonably point out, has little to say about the danger that caring for the poor will destroy their incentive to work. Dependency was not much of an issue in the agricultural economy of 2,000 years ago.

Some senior members of the Church of England are responding to Mrs Thatcher's forays by reviving the nineteenth-century questioning of the links between church and state. All changes in the practices of the Church of England have to go through Parliament. The ecclesiastical committee of both houses of Parliament, which is supposed to vet church legislation only for drafting errors, is threatening to overturn a measure which could allow the ordination of divorced people. Mr Tony Benn, a left-wing member of the Labour party, has proposed a bill to disestablish the Church of England. Most frustrated Anglicans think the process should be gradual rather than sudden. But Mr Benn may win more support from the institution itself than he expects.

Trades Union Congress

Solidarity dissolves

FOR two years Mr Eric Hammond's electricians' union, the EETPU, has been scrapping with other unions. On May 25th the row intensified. The general council of the Trades Union Congress (TUC) decided formally to start proceedings to expel the union from the movement. Few expect it still to be inside the TUC next year—least of all Mr Hammond.

Other unions have been expelled from the TUC before. A few were temporarily relieved of their affiliation for co-operating with the Tory government's 1971 industrial relations act. The forerunner of the EETPU itself was expelled in 1961 after its then Communist leaders were found guilty of ballot-rigging by the High Court; it was that fight which brought the union's members to vote for more right-wing leaders, who have led on to Mr Hammond. Some trade unionists recall a TUC conference in 1977 from which the mighty transport union was expelled for an hour or so.

But the latest proposed expulsion threatens a more significant split in the TUC than any before. Its cause is a row over what an association of trade unions is all about. Other unions resent the EETPU's collaboration with Mr Rupert Murdoch at Wapping, and its readiness to conclude strike-free deals with employers. Mr Hammond says that London TUC bureaucrats should not be allowed to tell independent unions what deals they may sign, and even instruct them on what agreements to break. His opponents say that unions must not undercut each other in offering sweetheart terms to employers.

The split will cause some ugly scenes. In June Mr Hammond will put his case to the general council. In July he will ballot his members on whether they reject TUC interference. In August the row will presumably enliven the TUC's congress itself, and may turn many viewers to Mr Hammond's side. The next question is whether the much bigger engineers' union (AEU) will join the electricians outside the TUC. The two are supposed to merge by next March, and the engineers' national committee has passed a resolution rejecting TUC interference. The question after that will be whether lots of

unions may split, with groups in each wanting to embrace the new EETPU-AEU model.

A decade ago the threat of all-out war between unions would have terrified employers. They remember when half of Britain's strikes were about demarcation or inter-union disputes. That has now changed. Furious competition there will surely be, but it is likely to be for single-union recognition in new workplaces. That will not provoke more strikes; it will let employers get away with more favourable terms.

The electricians' departure is likely to have little effect on the TUC's future. With no social contract to sign and no incomes policy to enforce, the TUC is little more than a talking-shop anyway. Its rules on recruitment were already beginning to fall apart.

And the Labour party? Because the electricians' union backs Mr Neil Kinnock, the party's top brass will be keen not to expel it, whatever the TUC may do. The party's rules state that unions may affiliate to it only "if they are declared to be *bona fide* unions by the TUC. If the TUC said the EETPU was not a *bona fide* union, the battle could move to the courts.

Labour shortages

The old country

HISTORIANS know that population changes can destroy empires and wreak industrial revolution. But businessmen and employers, with shorter time horizons, are slow to notice them. That may be why few are yet thinking about how to cope with the shortage of young workers which will hit them in the 1990s.

Estimates in this month's *Employment Gazette* suggest that the total of British school-leavers available for work will fall by a fifth between 1987 and 1991. Rising education standards mean that the fall will be even sharper for the less well-qualified: there are expected to be 27% fewer people leaving school in 1994 with less than five higher-grade O levels than there were in 1987.

One big employer, the government, has begun to wake up to the implications. This week the social-services secretary, Mr John Moore, accepted proposals to improve and extend nurse training and to widen the necessary entry qualifications. Both the pay and the career structure of nursing have been improved. The hope is that health authorities will avoid the effect of a fall in 16 to 19 year olds by pushing up retention rates, attracting back leavers and drawing in less-qualified staff. The education secretary, Mr Kenneth Baker, has also just announced plans to beat the teacher shortage by making it easier for mature but unqualified people to take up teaching.

Health and education are affected by de-

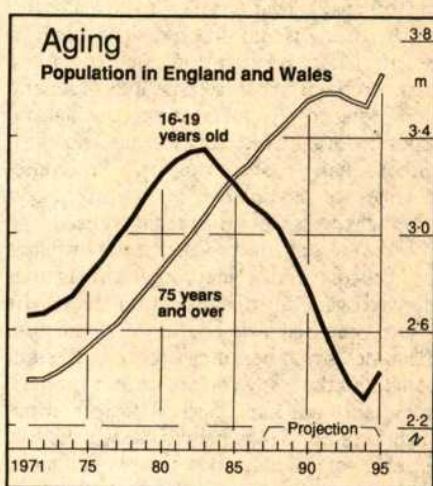


Hammond goes it alone

mographic changes among their clients as well as in their workforces. The shrinking pool from which nurses are drawn will have to look after growing numbers of old people (though there will be a lull in the early 1990s, the echo of the low birth rate of the first world war).

Teachers and education authorities are only just getting used to falling school rolls. Although fertility rates are still falling, the women born during the baby boom of the early 1960s are now starting to have children of their own. So in the 1990s primary-school rolls will rise again.

The labour market is already responding to demographic changes by bidding up the wages of young workers. That will make employers more eager to hire older people, including mature women who may find that their own pay rises faster than that of their husbands. If, as a result, more married women work for more hours, fertility rates would fall even further. The result might eventually be a falling population in Britain—something that has begun to happen in West Germany already.



Demography is changing work-patterns too. Service industries (including much of the public sector) that have grown lazy in an era of labour surpluses should in future worry more about using their staff efficiently. They might also start to employ more of the middle-aged men who once worked in manufacturing. One population researcher, Mr John Ermisch, says that he has noticed more middle-aged men working at grocery check-outs in America—and thinks that the same will happen in Britain.

Most countries in northern Europe are short of teenage workers. The Mediterranean countries—Spain, Portugal and Greece—are not. If 1992 brings with it greater labour mobility between EEC countries, one consequence could be a big influx of workers from the Mediterranean to meet demand in northern Europe. It would be even bigger if Turkey were to join the EEC.

Unemployment Sticks or carrots

WHEN unemployment is falling, the long-term unemployed, who have been jobless for a year or more, are usually the last to find work. Now this link seems to have broken. Over the past year the numbers of long-term unemployed have fallen faster than the total. Why?

Mainly, says the Employment Institute, a group of campaigning economists, because unemployment benefits have become harder to get. Indeed that is the main reason

why unemployment in Britain appears to have fallen faster over the past two years than in any other industrial country (see chart on next page). Adult unemployment in April fell below 2.5m—its lowest level for seven years. On national definitions, Britain now has a lower unemployment rate (8.8%) than West Germany and France.

This cheerful result, says the institute, is partly achieved by counting people in receipt of those harder-to-get benefits. If you count instead the difference between measured employment and the labour force, then unemployment has declined by less than 200,000 over the past two years, compared with the official drop of 750,000. By

Bangers and cash

MR TOAD, of "Wind in the Willows", was inordinately proud of his shiny red motor car. More and more Britons these days share his enthusiasm. The market in classic cars is motoring ahead almost as fast as his purr-purring vehicle did up the country lanes around Toad Hall.

Last October's collapse of world stockmarkets has helped move money out of paper and into tangible assets. Veteran and classic cars have shared the benefits. At the top end of the market especially, prices have roared. Cars costing £250,000 or more—50-year-old Bugattis, Alfa Romeos, Bentleys—have seen their value rise by 30%-50% in the past 12 months, according to Mr Stewart Skilbeck of Sotheby's.

Cars that raced in competitions sell best. Earlier this month Christie's sold a 1936 Alfa Romeo race-winner for the world record price (for a Grand Prix car) of £1.5m. Last year a Bugatti Royale became the most expensive car ever, when it was sold at an auction for £5.5m. The anonymous buyer is rumoured to have sold it on privately already, for around £7m.

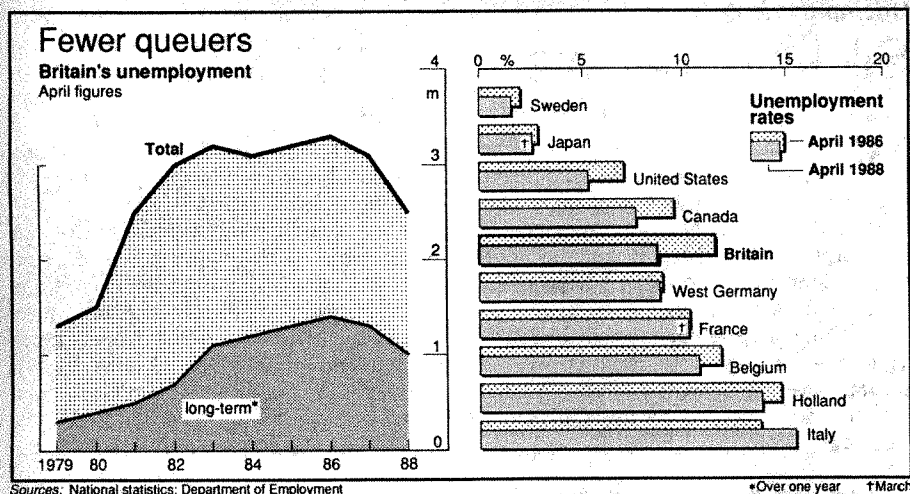
Not all classic-car collectors have to be immensely rich. Most of the demand is for cars costing between £10,000 and £15,000, and more of the buyers are people on high salaries, perhaps from the City, who are buying their first classic car. Some are investing their own spare cash; others are taking advantage of the fact that a few companies are waiving the rule that a company car has to be new. Almost all are men; fewer than 5% of buyers at a typical Sotheby's auction are female. Most tend to buy open-top, two-seater sports cars: perhaps an Austin Healey, a Mercedes or an old MG. The value of these cars has gone up by about a quarter in the past year.

Two worries may stall the overenthusiastic. British classic-car magazines are now full of advertisements from American dealers. The weak dollar has sent a flood of cars to Europe. "Go down to almost any dock, and you will see container-loads of old cars being discharged," says one classic-car auctioneer. The white-walled tyres and chromium-plated wheels are a tell-tale sign of an American restoration. Some were bought by Americans in 1985 when the dollar was strong, and are already streaming back across the Atlantic.

Although the gross profits to be made on resale may look impressive, they ignore the costs involved. Classic cars have to be kept in a garage, and they may cost a lot to insure and maintain. Enthusiasts retort that the rise in prices should make the possession of a classic car self-financing, and that cars have plenty of advantages over stocks and shares. More fun, for a start.



A chrome-edged investment



summoning all the long-term unemployed for a Restart interview, and by imposing a stricter availability-for-work test, the government has driven people off the unemployment register.

On the contrary, says the government, the fall in the numbers of long-term jobless shows that its policy of targeting measures on them is starting to work. There are currently some 700,000 job vacancies in Britain. Most of the long-term unemployed have little chance of filling one of those jobs, partly because they lack the right skills. The government's new Employment Training programme, due to come into operation in September, is designed to help. Each year it will give 600,000 adults who have been unemployed for more than six months up to a year of training and work experience.

One big obstacle remains: the unions, who have two objections to the new scheme. They want trainees to be paid something close to the rate for the job rather than the normal social benefits plus £10 a week or so of top-up. And they fear the scheme is the first step towards making benefits depend on participation in the training scheme.

American-style workfare might be unacceptable in Britain. But a more palatable version has been operating in usually socialist Sweden for 40 years. There the unemployed receive generous social-security benefits. But if, after a year, an unemployed person refuses to accept a job or training, the benefit is withdrawn. This big stick is combined with a carrot: each unemployed person is guaranteed a place on a government job or training scheme.

Sweden's rules on eligibility for benefits sound tough, but their motive is to help the unemployed, not to trap the scrounger. The longer people are out of work, the more dependent they become and the worse they are at finding jobs. They need to be forced to retrain and seek work. Thanks to its sanction-and-incentive approach, Sweden has an unemployment rate of only 1.6%.

As a proportion of its GDP, Sweden spends almost four times as much as Britain

on adult training and employment services. It provides many more places and spends more than twice as much per trainee per year. In Britain some two-thirds of those on existing schemes for the long-term unemployed end up back on the dole. Inadequate training is partly to blame.

Even if Britain spent much more on training, it would find it hard to match Sweden's job guarantees. In Sweden the task of providing trainees with permanent jobs has tended to fall mainly on the public sector. Is all that training worthwhile, if private employers—who have to operate in competitive markets—still spurn its end-products?

Divorce

Easing the pain

IF YOU loathe your husband after one year of marriage, will you loathe him any less after three? It is perfectly possible if you work at it, says the National Campaign for the Family (NCF). Splitting up is too often seen nowadays as the first resort for a floundering marriage. The NCF has now launched a campaign to persuade the government to ban divorce within three years of marriage instead of one, as has been the rule since



1985. And the Law Commission—a statutory body that reviews and suggests changes to the law—has just published a discussion paper on the future of divorce law.

The commission's approach is more realistic than the NCF's. It recognises divorce as a fact of life. It does not propose that a palpably unhappy marriage should be prolonged, but puts forward changes that might instead reduce the inevitable agony and acrimony suffered by the couple and witnessed by their children when divorce is applied for.

Under present law, says the commission, the only ground for divorce is a "no-fault" irremediable breakdown of the marriage. This is misleading, for it can be proved only by showing one of five facts, three of which depend on fault: adultery, intolerable behaviour, desertion for two years, separation for two years plus the other party's consent to divorce, or separation for five years. Most couples—over 70%—find the separation periods intolerably long and plump for one of the first two options.

This encourages bitterness and bad feeling, because allegations have to be made and all the blame is laid on one party, when in practice there is often not much to choose between them. Protracted periods of separation reduce the chances of a reconciliation. Couples are forced to rake up the past, rather than concentrate on the consequences of a divorce and think again whether this is what they really want.

Two recent surveys carried out by teams at Bristol and Newcastle Universities showed general dissatisfaction with the present divorce law. The Law Commission examines a number of possible changes but concludes that only two are serious runners:

- A fault-free fixed period of separation, such as in Sweden, which is used as the sole ground for divorce. But this would mean that spouses would no longer get an immediate divorce for things like adultery or desertion. A mother with young children must find it almost impossible to afford to separate from a husband she wants to divorce.
- A fault-free agreement that the marriage had broken down. After making a statement to the court that the marriage had collapsed, the couple would be given a period—perhaps a year—for reflection and sorting out all the practical arrangements.

The NCF fears that either change would mean more divorces. Britain already has the highest divorce rate in Western Europe (though America's is almost double). The Law Commission thinks its proposed changes would have little impact. Happily, there are already signs that the divorce rate is flattening out. That may be because couples are marrying later—fewer than 10% of British brides were teenagers in 1986, compared with 25% only 15 years ago. Later marriages tend to last longer.

BUSINESS THIS WEEK

Bids and buys

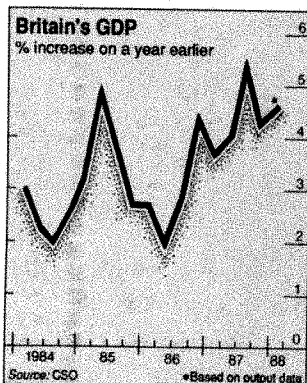
Carl Icahn launched a bid for **Texaco** which values the company at \$14.5 billion.

The British government cleared the way for a bidding war for **Rowntree**, a confectioner which makes Kit Kat chocolate bars. Two Swiss groups, Nestlé and Suchard, bid more than £2 billion. Despite staunch local political and press opposition to a foreign takeover, the government decided not to refer the issue to the Monopolies and Mergers Commission.

Ford paid \$425m to buy BDM International, an American high-tech consulting and computer software company which sells mostly to military customers. The acquisition takes only a small bite out of Ford's cash hoard of around \$10 billion, after four years of excellent profits.

American Airlines ordered 50 **Boeing 737-200s**, worth more than \$2 billion. The deal will benefit Boeing, which had sold only 276 of the aircraft, and Rolls-Royce, whose engines will power these aeroplanes.

Economies



Britain's GDP in the first quarter of 1988 was 4.6% higher than it had been a year earlier, but preliminary output-based figures suggest a

slowing from the rapid pace of advance in the second half of 1987, especially in manufacturing.

Japan's gross overseas assets grew by one-third last year, up \$60 billion to reach \$241 billion. That put Japan far at the top of the world league table of creditors, for the third year running. The Bank of Japan, in its efforts to support the falling dollar against the yen, accounted for much of the jump.

Mexico said it would freeze the value of the peso until after the presidential elections in July, which would mean spending some of its precious \$17 billion of foreign-exchange reserves. The government also unwrapped yet another package of economic reforms.

Bits and bytes



Robert Allen, AT&T's chairman, said the company will curtail purchases of personal computers from Italy's Olivetti in which it holds a 22% share. Sales of Olivetti computers in America have been disappointing, and the dollar's fall against the Italian lira is making them unprofitable.

The first American-Soviet **personal-computer joint venture** should have a more appreciative market. Advanced Transducer Devices, a Silicon Valley company, plans to assemble IBM-compatible personal computers in Rus-

sia—together with Electronorgtechnica, a Russian trading company.

Matsushita, a Japanese electronics company, will start making personal computers in America to sell to IBM. Matsushita had been supplying computers to IBM from Japan until America slapped 100% tariffs on Japanese personal computers in retaliation for alleged infringements of the two countries' semiconductor-trade deal.

Trade

President Reagan vetoed the controversial **trade bill**, following a two-to-one vote in its favour by the House of Representatives. Mr Reagan objected to clauses that would have required companies to give 60 days' notice before plant closings and large-scale layoffs, and that proposed restrictions on the export of Alaskan oil. The House of Representatives voted to overrule the veto. Will the Senate too?

Countertrade is on the wane. After a peak in 1985, the number of countertrade contracts signed has fallen; developing countries engaged in countertrade fell from 72 in 1986 to 65 last year.

People



Hisashi Shinto became chairman of Nippon Telegraph and Telephone, Japan's biggest

company, moving up the ladder from his previous post as the company's president.

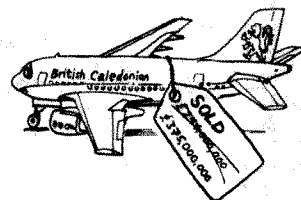
John LaWare, a Boston banker, will be nominated by President Reagan to take the seat on the Federal Reserve Board vacated by Henry Wallich.

Disaster at sea

The month-long fire that destroyed **Brazil's biggest offshore platform** is likely to produce the world's highest offshore insurance claim—up to \$330m. Nobody was injured in the fire, but it has caused the loss of 11% of Brazil's oil and gas supply.

Iran has lost around 50,000 barrels of oil a day since last October, because of attacks on its offshore drilling platforms by American warships.

Bottom lines



British Airways is the world's most profitable airline. In fiscal 1987, its pre-tax profits were £228m (\$388m), a 41% jump from the previous year. But the £246m BA paid for loss-making British Caledonian turns out to have been the tip of an iceberg: consultancy fees, redundancy payments, and continued losses from BCal added £129m to its cost.

Sony, a Japanese electronics company, reported a 47% jump in net profits, to ¥36.7 billion (\$265m). Despite a poor export performance because of the higher yen and competition from other Asian producers, sales rose 10.5% to ¥1.4 trillion.

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May 1988

BUSINESS

Why half-reformed communism isn't working

In the week when the Hungarian communist party threw out the original defender of economic reform in favour of someone even more radical, a distinguished economist in an East European country reports, with anecdotes from all round the bloc, why Gorbachevian economics is struggling so slowly uphill

IN THE old centre of Cracow, one of the most polluted cities in Europe with gutting tap water, there wells up a healthy mineral water. The authorised state enterprise is unable to bottle it fast enough, so most of the mineral water pours into the municipal sewage system. A private enterprise with access to "foreign ethnic capital", proposed a joint venture. The general manager of the state bottlers turned this down flat, and Poland now has a free enough press for a local newspaper to ask why.

The state manager was behaving rationally. His bonus and local power do not depend upon bottling more mineral water, but upon showing loyalty to his superiors. They would react to any manager who dabbles with private enterprise by extra auditing of his state enterprise's books, which few such books can stand. Two years ago Polish newspapers praised CSK, a private firm producing

successful computer software in Gdansk. In the next three months the firm was subjected to six different audits by various state bodies, including the local arm of the Anti-Criminal Activity Board. In Poland, it does not pay to advertise.

In the congealed Soviet Union co-operatives are not being set up at the speed Mr Mikhail Gorbachev and his prime minister, Mr Nikolai Ryzhkov, wanted. When a new co-operative tries to purchase tools or components from a big state firm, or raw materials from a state warehouse, it is told "you have no limits." This means that new co-operatives are not on the list of receivers of rationed goods—without which production is nearly hopeless.

An especial disappointment for Russian consumers is that there has not been any rush to open new co-operative restaurants or cafeterias, or to take over old loss-making



Patience, comrades

ones on an agency basis, despite enormous unsatisfied demand. Some of the thwarted restaurateurs blame this on the bureaucracy's obsession with plans that are doddily imposed even upon new entrepreneurial ventures, and insistence on a myriad of regulations and audits.

A franker reason is that state catering workers—who might otherwise become restaurateurs—at present make a good living by pilfering and reselling on the black market all of the nicest foods in short supply. If they were in the private sector their incomes would fall because it is not profitable to steal from your own business.

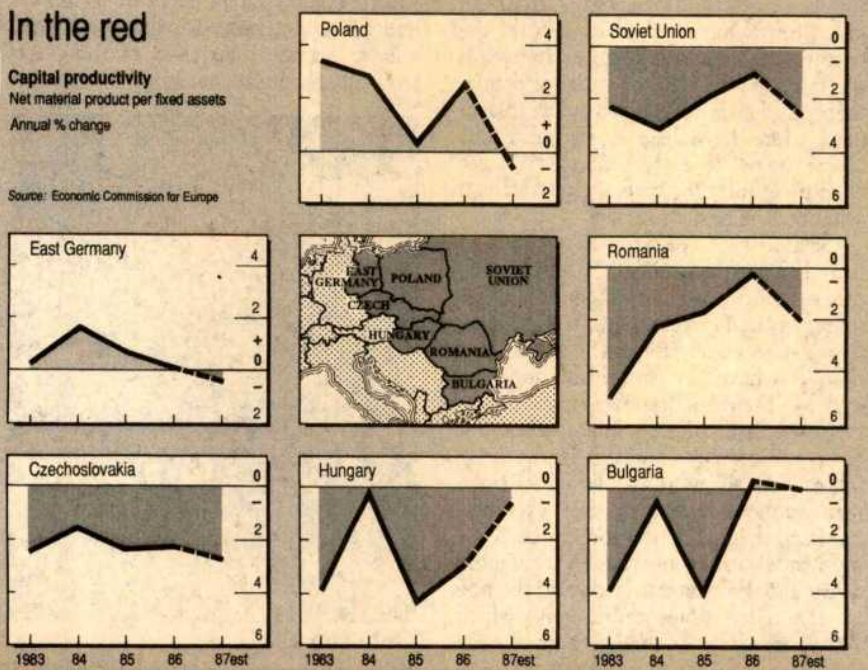
This opportunity to steal within state enterprises helps explain why Hungarians responded to their freer-market reforms 20 years ago by becoming moonlighters—keeping their state jobs while starting much more productive private ones on the side. The new government's Thatcherite reformers want to curb pilfering, and some moonlighters are cross. An engineer in a 17-man business partnership told a survey: "Originally all 17 of us started to work for our business partnership as part-timers, but now eight of us work full time. This became a necessity, since we were harassed a lot in our firm—including me, although I worked for 29 years in the company."

Some reforms are retreads of policies which were abandoned before. In Bulgaria anybody who buys a new car from a state factory has to pay in advance, and then wait six to eight years for delivery. People who could get immediate delivery of a second-hand car are willing to pay well above the official list price applied to new cars, and for

In the red

Capital productivity
Net material product per fixed assets
Annual % change

Source: Economic Commission for Europe



BUSINESS

a time the Bulgarian authorities allowed second-hand sales to take place in a free market. Then they said that a free market had brought unacceptably high prices, so two state firms were given monopoly rights for buying and selling used cars. Today everybody would like to buy these second-hand cars at the local monopoly's low prices; but it has not got any because nobody is willing to sell their cars to it. Owners have found a new way of re-establishing scarcity prices by advertising sales of cars as car parts. The sale of a car as an assembly of parts gives an owner about twice as much as he would get from the state monopolists. The Bulgarians may re-open the free market.

Slightly freer production does not meet demand. In Poland there are now far more private firms producing building materials than there were ten years ago, but the desperate shortage of bricks, tiles and guttering continues. High taxes are to blame. If a private brickmaker trebles output from 1m to 3m bricks a year, the tax rate on its owner rises from 75% to 95%. As a result, private

building-material firms employ on average only two workers plus the owner. The most economic size for a firm would probably be 10-12 workers. If the top tax rate on owners were cut from 95% to 65%, analysts of the Polish building-components industry believe it could treble output and thus pay much higher total tax revenue. The owner of the oldest furniture-moving firm in Poland says his firm succeeds because it is the only one allowed to have several vans. Newer rules say that a private firm can own only one van and the owner has to be behind the wheel—which makes profitable operation impossible.

While the new private firms are not being given free rein, the crisis in the old state industries grows ludicrously worse.

Corrosion across frontiers

The uncoated steel pipes used in Soviet oil and gas pipelines have to be replaced every two or three years, because of the corroding effect of hydrogen sulphide. This problem is being met not by coating the pipes, but by

huge repair and maintenance operations. These repairs count as part of the oil-and-gas industry's production, and thus increase managers' bonuses. As the industry is a priority, it has no difficulty in securing resources for the repair jobs. Grants, credits and higher prices allow priority industries to get all the metal supplies they want and to absorb all costs. Indeed, the higher the costs the higher is said to be the industry's contribution to net material product (which is GNP in cyrillic).

Without good pipe-coating technology, the steel pipes used in municipal central-heating and water systems in Soviet cities break down far too frequently. They are always repaired after they ought to be because the resources needed are being used for the more important job of repairing oil-and-gas pipes in Siberia. Enormous waste and freezing misery result. On average there is one breakdown per year along each kilometre of these pipes, which is 2½-to-5 times more frequent than in the late 1970s.

In 1985 and 1986 a car factory in War-

Zlot a lot of dollars

WARSAW

THERE is one state enterprise that is flourishing in Poland: turnover at Pewex, the chain of foreign-currency stores, rose 19% to \$440m last year. Pewex shops are a mixed blessing for the government. The local demand for foreign currency they create bolsters Poland's ever-growing black market for dollars, nudging official and unofficial zloty values ever downward. The shops are tolerated because, for every dollar Pewex receives from its customers, it hands 55 cents to the state.

In a country where hard-currency debts at the end of last year totalled \$39

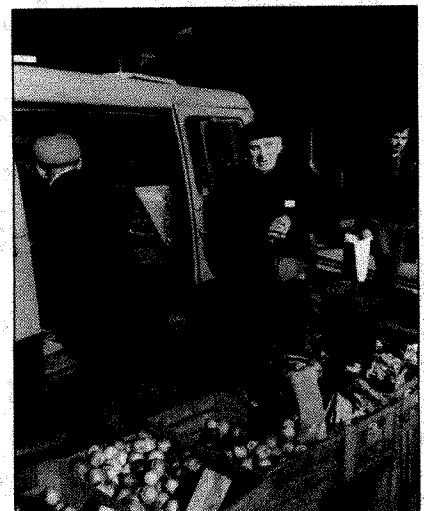
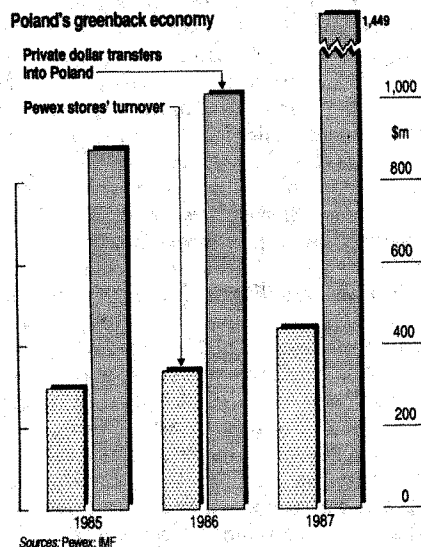
billion, up \$5.7 billion from the year before, this flow of foreign money is precious. Pewex will continue to grow, as will the black economy.

Pewex stores are a convenient way of rationing scarce goods by price (the day's black-market exchange rate) rather than queuing. Alcohol and videotape recorders are the two biggest sellers in Pewex stores, followed by food, cigarettes, clothes and cosmetics. From day to day, demand and supply of Pewex goods, rather than demand for dollars themselves, tend to determine the price of foreign exchange on the black market. Polish vodka accounts for around 20% of Pewex turnover. Black-market rates for dollars were around 10% above today's levels two months ago, fuelled by a thirst for vodka with which to celebrate the Easter holidays.

Sales in 1988 are expected to rise by at least 12%, to around \$500m. Like many other Polish forecasts (including those found in the five-year plan), this is guesswork; sales could rise much faster than that. "We have a system without money", says Mr Stephan Bratkowski, an economist and dissident; zloty inflation last year ran at around 26%, and this year is jumping towards 40%; unscathed by its treatment in more familiar overseas exchange markets, the dollar (the foreign currency most widely used) buys roughly what it did a year ago. Foreign currency, and the dollar-dominated notes called *bonny* which Pewex hands out as change to its custom-

ers, are used for all sorts of private transactions. Dollars can cut the waiting time for a new car from around three years to three days.

Poles were first allowed into Pewex stores in the 1970s. Before then they were for foreigners only. Most of the money spent in the stores comes in the form of private remittances to Poles from relatives living abroad, held (legally) in foreign-exchange bank accounts. Remittances have been rising fast in recent years. In the first nine months of last year they were up 43% on the same period a year before. Estimates on the pool of dollars circulating within Poland range between \$3 billion and \$4 billion, stored in bank accounts and under the mattresses of those less trusting of the state banks.



Only \$1 a kilo

An exchange-rate map, part 2

Last week's Economics Focus explained that most exchange-rate systems call for some combination of co-operation between governments and/or explicit rules to limit their freedom. This week's article asks which mixture of the two works best

CHART 1, introduced last week, plots a selection of exchange-rate systems according to two criteria. The vertical axis measures each system's reliance on rules as against discretion. The horizontal axis measures economic co-operation between governments. Fun as it is to puzzle over where to put each system, the chart as we left it offered no pointers for governments. All four quadrants can claim systems that worked and systems that failed—or, as in many cases, systems that worked for a while and then failed. Before the chart can be more helpful, it is necessary to be more precise about what "success" means in exchange-rate policy.

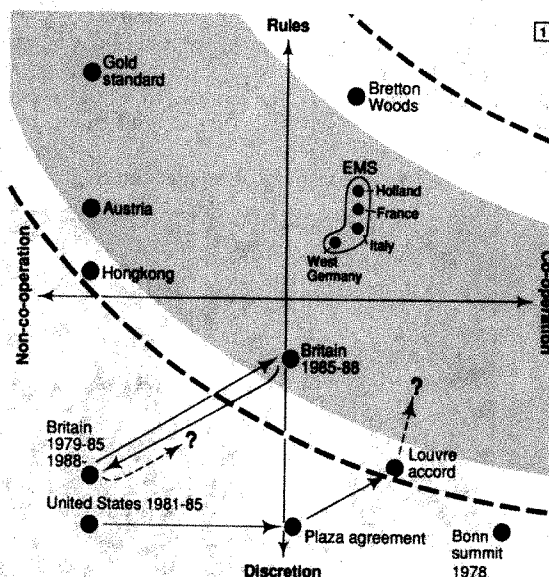
Arguably, what matters most is credibility. If an exchange-rate system is both properly understood and expected to last—the two rarely go together—it provides a stable background against which businessmen and others can form their views of the future. Certain sorts of volatility will remain. For example, under credibly fixed currencies a change in fiscal policy is likely to cause bigger swings in interest rates than when the peg is thought likely to give way under pressure. But credibility at least means that the system itself is unlikely to be a source of surprise.

It seems safe to say that economies grow more slowly when dogged by uncertainty, and that credibility reduces uncertainty. A different, though related, benefit is that when policymakers are judged to be credible they find it far easier to get their way. Suppose a government states that it will peg its exchange rate, but the market thinks the currency will come under pressure. If the commitment is believed, the government should be able to defend the peg merely by saying it will. If its promise is not credible, defending the rate will mean either changes in interest rates or foreign-exchange intervention.

Chart 2 considers how the credibility of policy (which is measured on the vertical axis) might vary according to the reliance on rules as against discretion (the horizontal axis). To the extent that a government has an exchange-rate policy of any sort, its credibility is likely to increase up to a certain point as reliance on rules increases. A policy that allows too much

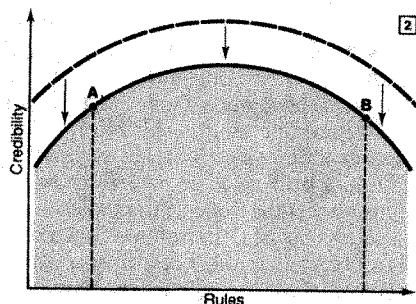
ECONOMICS FOCUS

freedom makes declarations of intent on exchange rates suspect. (Point A represents such a policy: the Louvre accord, say.) Equally, though, over-rigid rules may start to undermine the government's credibility. That is bound to happen, for example, if the rules become mutually in-



consistent, or if the government seems to be promising too much. (Such a policy would appear as a point like B: Bretton Woods?) So the credibility curve starts by sloping upward and then falls.

The curve takes co-operation as fixed: in effect, it represents a line drawn vertically down chart 1. What will the curve do if co-operation varies? A plausible guess is that its shape will alter. At high levels of co-operation, it is likely to turn down faster as rules increase, because the system



will arrive that much sooner at the problem of trying to do too many things at once. Conversely, at low levels of co-operation, credibility is likely to rise for longer as rules increase, because the system has little but rules to rely on.

This thinking has been transcribed on to chart 1. At any level of co-operation the shaded region shows a range of choices on rules and discretion, all of which provide a credible policy. Call this the zone of credibility. Outside this zone policies lack credibility because they have either too few rules or too many. The zone slopes downward from left to right. In other words, more co-operation allows governments more discretion while still maintaining a credible exchange-rate policy. In addition the zone's centre of gravity is more than half way up the chart, reflecting the view that it is better to have too many rules than too few. The resulting pattern seems more or less to fit the facts. The zone embraces most of the "successes" and excludes all the "failures".

Bretton Woods is an interesting, and revealing, exception. This system lasted for nearly 30 years before it collapsed. Despite that long period of success, few think that a new Bretton Woods could work today; most of those who pine for more rules want something less rigid, like the EMS. Is the credibility zone therefore shrinking? That seems likely. The growing integration of international capital markets means that capital is freer to flow around the world in response to snippets of new information. That makes maintaining an exchange-rate policy a trickier task, though it also increases the benefits to be gained from doing it well.

In terms of chart 2, bigger flows of capital are pushing the curve down; this corresponds to the shrinkage of the zone in chart 1 from the earlier boundaries marked by broken lines. The possibility of shrinking credibility suggests that governments should not be content to adopt a system within the zone, but should also try to slow or reverse the shrinkage by fostering credibility in ways that have nothing to do with rules or co-operation. Reputations take time to build, so the reward for loyalty to any chosen regime will usually be a rising credibility curve. Above all—regardless of what other governments are doing—pursue boring, unadventurous macro-policies so as to give the markets as few upsets as possible.

saw fulfilled its output plan, but only because some parts had to be rushed to Warsaw by helicopters from suppliers over 300 miles away. This novel variant of a just-in-time inventory system necessarily applies to "priority industries" only. The factories that are not on the planners' list are not serviced by helicopters; when they have not got adequate supplies, they just stop producing for a time.

Another Polish vehicle producer, a van factory in Starachowice, has recently been selling bonds at interest rates far below the inflation rate. Why does anybody buy them? Because the bonds carry a promise of priority in buying new vans. This is an inefficient way to compensate for lack of a market mechanism to distribute things where they are wanted. But, on the supply side, the lack of mechanisms to distribute effort where it is wanted is far worse.

A recent study by some Chinese economists, funded by the World Bank, sought to discover the relative profitability in communist China of enterprises that were facing a sellers' market (ie, producing things people wanted) and those producing things that did not seem to be wanted much. It showed almost equal profitability—25.1% for those facing a sellers' market, and 23.3% for the rest. If a similar study were made in almost any communist European country, it would show even sillier results, which is why the most tiresome shortages continue.

The toilet-paper crisis

The Economist last March 5th noted that before Taiwan dashed for freer markets in 1960,

Taiwan was an island of penury. One of its biggest businessmen says "We didn't even know about toilet paper—we used bamboo sticks". Today, the island can buy toilet paper by the forest.

The Soviet Union, Czechoslovakia, Poland and Romania have plenty of forests, but their lavatories don't profit from that. One of the banners recently carried by demonstrators at Wroclaw, Poland read: "Socialism is a system for raising toilet paper to the rank of a first-rate economic problem".

These misfortunes will continue so long as communist countries keep their economies in a state of chronic overdemand, and without enough market-driven enterprise. The overdemand is growing worse, even while officials say the opposite.

"There is no reason why Poles should be condemned to a bad currency", proclaimed the president of the Polish National Bank, when presenting his programme to strengthen the already overvalued Polish zloty and curb inflation in early June 1987. In the year since his announcement, inflation in Poland has risen from 25% to nearly 40%, and the budget deficit has increased to more than 300 billion zlotys.

West German businessmen

The left-wing bosses

BONN

MR HEINZ RUHNAU, chief executive of Lufthansa, looks the kind of boss workers love to hate. Cool, precise, determined (some say ruthless), he constantly drums home the need for more productivity, cost-cutting and wage restraint. At Lufthansa, he has chopped bureaucracy, streamlined decision-making and revamped sales and marketing. Though the airline's net profit rose in 1987 by DM22m to DM86m (\$48m), he says that even tougher action is necessary in preparation for the single European market planned for 1992.

The model of a modern German manager? Not quite. Mr Ruhnau was for years a negotiator with the powerful metalworkers' union IG Metall. He once ran a 114-day strike to win sick-pay rights. Now he is one of a handful of Social Democrats who hold senior executive jobs. They are an unusually tough and wily bunch.

Mr Detlev Karsten Rohwedder, another

Mercedes cars. Because of his politics he was passed over at least twice for the top job, before getting it last year. Now he faces friction with party friends. They dislike Daimler's "Gigantomania"—gobbling up other companies like Dornier and AEG. And they hate the group's emergence as the country's biggest producer of military equipment.

Mr Manfred Lahnstein, the former Social Democratic finance minister, suffers similar but smaller irritations. As a board member of Bertelsmann, the world's biggest media company, he is responsible for private television. Some of his party comrades treat this with reserve, and also sniff (whether with envy or disdain is hard to say) at his large salary. Bertelsmann board members earn on average around DM1.5m a year.

Messrs Ruhnau and Lahnstein came to social democracy via the trade unions. Mr Rohwedder was dazzled by Professor Karl Schiller, a Social Democratic economics



Hands-on managers: Reuter, Pöhl, Lahnstein

Social Democrat, stepped out of the shelter of the Economics Ministry in the late 1970s, where he had been a state secretary for nine years, to become chief executive of Hoesch, a steel group based in Dortmund. It was not long before angry workers were besieging his board room and parading through the town demanding his departure. The steel slump of the early 1980s forced Mr Rohwedder to cancel plans for a new steel plant and chop thousands of jobs, becoming one of the biggest bogey-men in the Ruhr. He is still not exactly the toast of Dortmund, but—to the surprise of those who at first judged him a social-democratic softie—Mr Rohwedder has stuck it out. Hoesch has diversified into electronics and machinery. Steel now accounts for less than one-third of sales.

Being a Social Democrat has meant double-trouble, too, for Mr Edzard Reuter, chief executive of Daimler-Benz, the country's biggest industrial group and maker of

minister. Mr Reuter's father was an outstanding leftist leader driven into exile by the Nazis. The Bundesbank president, Mr Karl Otto Pöhl, another prominent Social Democrat in a sea of conservatism, joined the party soon after the war as a reaction against any politics smacking of the right. He has stuck to his membership despite policy differences with other Social Democrats, including Mr Helmut Schmidt in the early 1980s. And he is one of a notable trio which confounds the rude old saying that "Die Sozis können nicht mit Geld umgehen" (Pinkos can't handle money). The other two are Mr Manfred Schüller, a balance-sheet wizard at the Kreditanstalt für Wiederaufbau, a big Frankfurt-based bank; and Mr Horst Schulmann, Mr Schmidt's former economic policy adviser and now managing director of the International Finance Institute in Washington.

British takeovers

Storm in a chocolate cup

BY NOT referring the question of its ownership to the Monopolies and Mergers Commission, Britain's trade and industry secretary, Lord Young, has started a bidding war for Rowntree, a chocolate maker based in York. He has also sharpened the conflicts between the national and European bits of Whitehall's competition policy.

The Rowntree affair poses a problem in merger policy for all EEC countries. Like Britain, they should be switching from running a national merger policy to one appropriate for the years after 1992, when the European Community is supposed to become a single market. During the interregnum, a Swiss bid for Rowntree cannot reasonably be referred to a national anti-trust authority because, in British terms, the effect on competition is nil. But what if Cadbury Schweppes, another British choc-maker under threat from foreign predators, were to

merge with Rowntree?

Two Swiss companies, Nestlé and Jacobs Suchard, have been jostling to buy Rowntree: Nestlé has already bid £2.1 billion (\$3.9 billion). After Lord Young's announcement Suchard upped the odds to £2.3 billion. Others may enter the fray. There will certainly be more European bids for British companies but has Lord Young's decision made British industry more vulnerable to hostile bids?

The short answer is no but that has not stopped the City searching for likely (and unlikely) British brand names which speculators say could be snapped up by foreigners. That fishing expedition landed only one early catch: Cadbury Schweppes, a chocolate maker with a shopful of international brands, like Dairy Milk and Schweppes Tonic, as well as a big hungry shareholder, America's General Cinema, which owns 18.4% of its equity.

The net has now widened to include other big British companies. After Cadburys, the two most talked about are Allied-Lyons and Ranks Hovis McDougall (RHM). Both have similar pedigrees: a collection of established brands and a potential

bidder. Mr Alan Bond, an Australian brewer, owns 7% of Allied, which markets successful drinks like Harveys, Courvoisier and Tia Maria as well as Lyons Red Label tea and Lyons Maid ice cream. Goodman Fielder, an Australian industrial firm, has built up a 30% stake in RHM, which makes Mothers Pride bread and Bisto gravy.

Affected by "brand mania" the City has also toyed with other names: eg, Guinness, a brewer and distiller, and Grand Metropolitan, a leisure group. Food manufacturers like Dalgety, Unigate and Northern Foods are also being picked on for individual brands. Some City analysts have even moved away from the food and drink sector and are whispering about other established British names: for instance, Boots (a chemist) and Reckitt & Colman (a household products group).

These exercises may keep highly paid City analysts occupied but they have an air of unreality. Few prospective buyers have been lined up for these "brand-rich" companies. And even those who are interested are unlikely to bid when the targets look so expensive.

Where new technology meets old

PITTSBURGH

SOME of America's fastest-growing companies are neither manufacturers nor services firms but a bit of both; they are found in high-tech and no-tech businesses. They apply computer wizardry to the age-old problems of manufacturing. Pittsburgh is a centre of such activity and the Carnegie Group a good example of it.

Carnegie was started in 1984 by four professors from Carnegie-Mellon University who wanted to put their computing expertise to work in the hard world of business (though they subsequently got bored by it and sold out). The company applies artificial intelligence, usually regarded as a far-out and unproven art, to humdrum applications.

There are few things more humdrum than a production line making computer circuit boards. But the job of deciding which line should move at what speed, and whether to switch a team of workers from one job to another, is complex. Because such decisions involve half a dozen other teams of people, a foreman on the production line often has to juggle more variables than an air-traffic controller. Carnegie Group designed a computer program for Digital Equipment which helped to make these decisions for them: it doubled the number of boards made in a year and saved the company \$12m.

Most of Carnegie's clients are high-

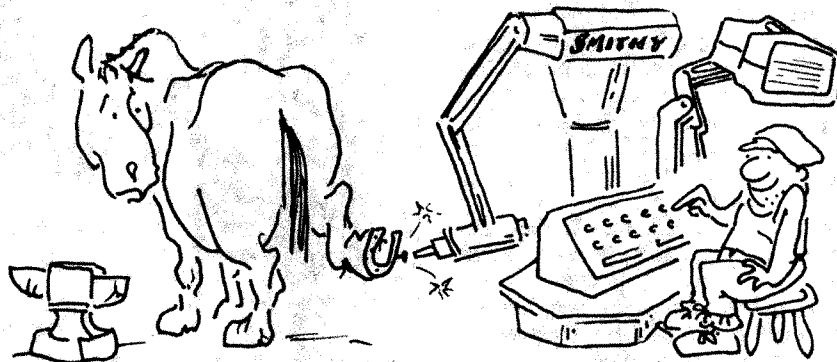
technology companies like DEC, willing to gamble a little on something as risky as artificial intelligence. Boeing, Ford, Texas Instruments, DEC and US West, a baby Bell, each own 10% of Carnegie's shares, have seats on the board and, between them, account for about 30% of the company's revenues.

Other customers are different. Ellwood City Forge runs a forging shop. Just old fashioned metal-bashing, but quite as complicated as a semiconductor factory (or as an air-traffic control tower). A forge bashes out custom-made pieces of basic steel: the company has thousands of orders, lots of equipment and no economies of scale. Because customers do not conveniently demand what is most efficient for

the forge to make, the organisation of the forge's workload is more important in giving the company an edge than, say, wage rates or new equipment.

Which is why Carnegie was brought in to improve this organisation with an artificially intelligent computer. With a grant from a charitable foundation, the company invented a program which works out the best way of reconciling the conflicting demands of customers and metal-bashing equipment. The project may or may not be profitable. But it has already shown one thing, as Carnegie's boss, Mr Dennis Yablonsky, says:

It doesn't matter if it's a \$60-billion Ford Motor Company or a \$50m Ellwood City Forge. If management believes they can use [artificial intelligence] to create a competitive edge, we've got a good prospect. If on the other hand management views technology as a necessary evil to be put off for as long as possible, they're not a good prospect...



The biggest bluff?

MR CARL Icahn is not a man of small gestures. On May 25th the corporate raider made a \$14.5 billion takeover bid for Texaco. Mr Icahn, who already holds a 14.8% stake in Texaco, played a large part in settling the company's long dispute with Pennzoil over Texaco's 1984 purchase of Getty Oil—a battle which drove Texaco into Chapter 11 bankruptcy. Mr Icahn is now seeking a reward for his help.

Texaco is badly in need of restructuring. Mr Icahn would like to see an aggressive sale of specified assets, linked to a share buy-back of some \$2 billion; Texaco is keener on a more orderly \$5 billion sale of its own (different) choice of

assets and a smaller share buy-back. That squabble led Mr Icahn to propose his own slate of five board candidates—including himself—for Texaco's annual general meeting in June. The company's response was to sue Mr Icahn for alleged violations of America's securities laws.

Mr Icahn says that his bid—which is open for only two days—is friendly. It is also a crafty negotiating ploy. Mr Icahn would like Texaco to call a shareholders' meeting to consider his offer; if the bid is not financed before the meeting, Mr Icahn says that he will forfeit \$100m to the company. If, as is likely, a meeting is not arranged, or if another bidder betters Mr Icahn's \$60-a-share offer, he will keep his \$100m. Mr Icahn is banking on another bid emerging—or senses that Texaco has a white knight in the wings.

in Hawaii are a sign of America's real intent. Property accounted for roughly two-thirds of Japanese direct investment in America last year.

Europe is Japan's favourite alternative to America, especially now that the business opportunities that might be created after 1992 are beginning to sink in. Japanese companies regard western Europe as an easy place in which to do business, especially high-technology business.

The companies that invest in America and Europe will do so because they want to make goods where their customers are; because they need to link manufacturing operations with existing marketing networks; or, in the case of service companies, because they have to provide offices in the places where their invisible exports go—financial houses in Wall Street or the City of London, hotels in California, department stores everywhere.

For companies which invest abroad because they want to cut costs, the future is likely to bring even bigger changes. Already Japanese manufacturers are shifting away from the dragons of Asia—Taiwan, South Korea, Hongkong and Singapore—because their labour costs are rising so fast.

Japanese companies have virtually stopped new investment in Taiwan because of the cost, often switching to Thailand instead. Some companies even talk of shutting down existing subsidiaries in Taiwan and moving them to Thailand (as Taiwanese companies themselves are doing). They may find Thailand is already full up. So heavy has been the influx of Japanese investment into Bangkok, that there is little obvious industrial and commercial land left there for new investment. The Thai government is

Japanese foreign direct investment

The diaspora comes home

TOKYO

This concluding article in our series on Japan's diaspora suggests that the country's investment abroad will change in the next decade; and that this will change the way Japanese companies think of themselves at home

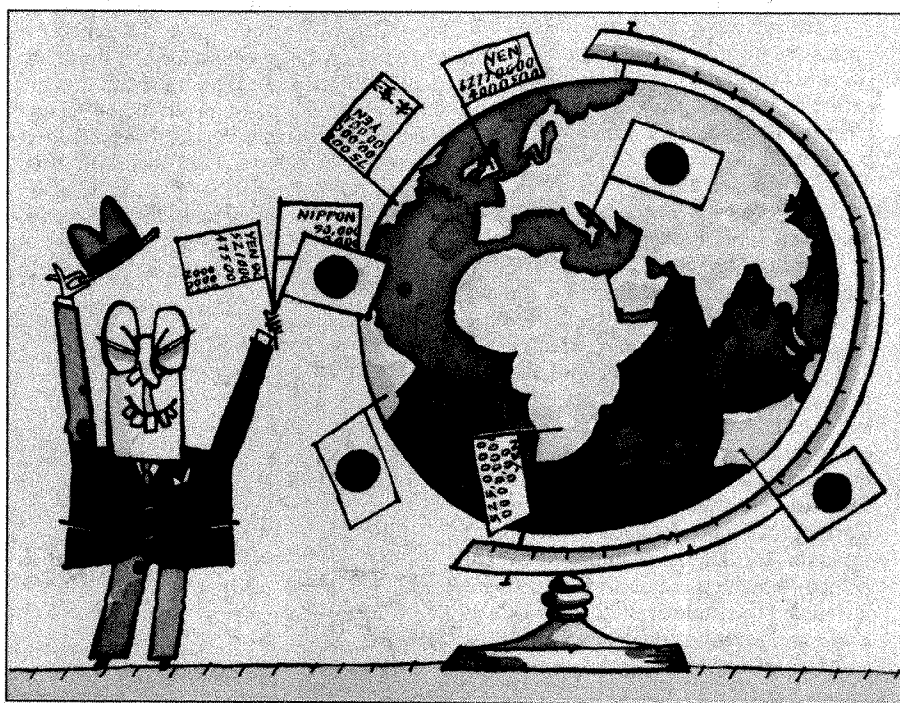


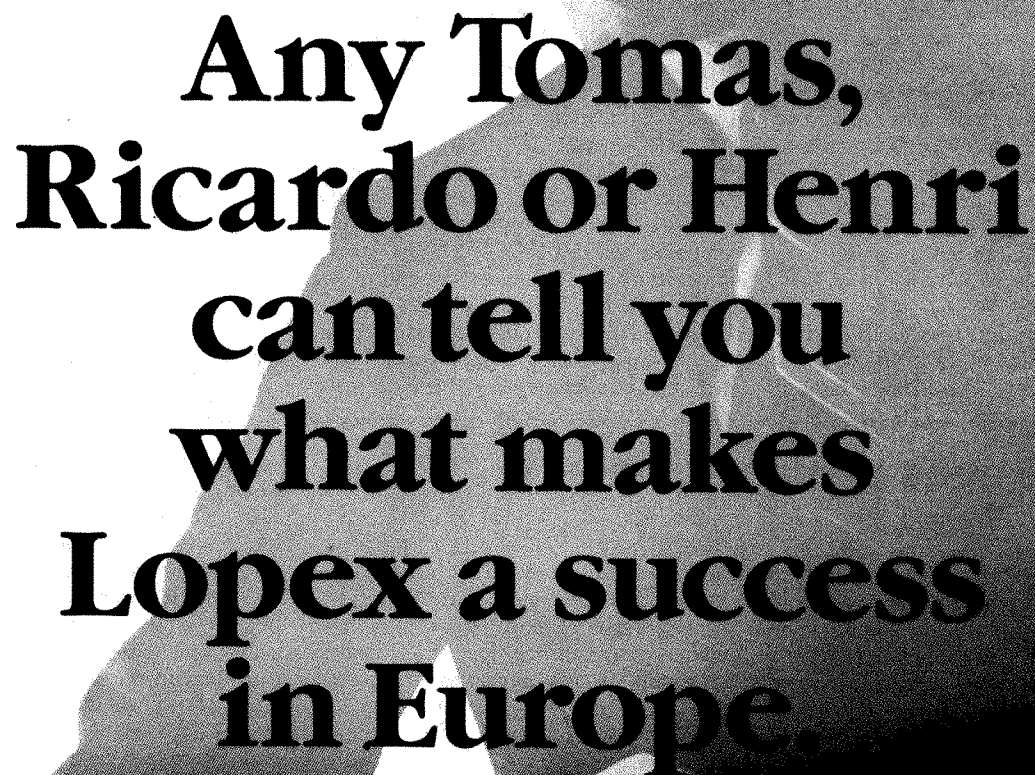
Japan's wave of foreign direct investment is cresting. In the financial year to March, investment overseas was \$33 billion, 50% higher than in fiscal 1986; in the year before, the rise was 83%; in the years until 2000, according to the Ministry of International Trade and Industry (MITI), investment will increase by an annual average of 14%. As economic growth is driven more by domestic demand and less by exports, Japan may become a diminishing capital exporter. And as big companies complete their first round of foreign investment, so the initial impact will wear off. A survey by the Japan Development Bank published last year found that nearly all big companies already have overseas investments.

That does not mean Japanese foreign investment will disappear, merely that the next wave will be different. It will wash up medium-sized companies on foreign shores (often component suppliers to big groups) and bring top-up investments by existing investors. Already, in the year to March 1987, there were 599 instances of foreign direct investment by small and medium-sized firms, up from 318 the year before.

North America will remain the main destination for Japanese capital exports, but its share will probably decline. In 1986 nearly half Japan's foreign investment went to the United States, and the Japanese government will try to discourage that from happening again. The number of billion-

buck takeovers of American firms by Japanese ones (such as Bridgestone's purchase of Firestone) has caused some worry at MITI. Although 40 American states keep representative offices in Tokyo to lure Japanese direct investment, the Japanese fear that recent attempts to prevent foreigners (for which read Japanese) from buying property





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BUSINESS

cutting back its investment incentives.

The next favourite may be China, which several banks and securities houses say is about to take off as a destination for Japanese investment. This view seems plausible: China is trying to open its entire seaboard to more foreign investment and has changed some of its joint-venture laws to allow full foreign control. This may help Japanese firms increase quality standards, which are dismally low in China.

Totting up

Japan's overseas production should cut the country's embarrassingly large visible trade surplus. The Industrial Structure Council,

an advisory agency to MITI, estimates that it will be worth \$19 billion in saved exports and added imports by 1990, rising rapidly to \$47 billion by 1995. That should reduce trade friction with America, but may replace it by takeover friction instead.

Some Japanese fear there could be a hollowing of Japan, as export of jobs follows the export of capital. MITI estimates that the increase in overseas production by Japanese companies will cost 600,000-800,000 jobs in domestic manufacturing by the end of the 1990s. Whether Japanese people perceive this as "taking away our jobs" will depend on how much domestic employment is created by ever-higher-tech manufacturing

companies and by new information-service industries.

Many people think that the way Japanese companies manage themselves will soon change fundamentally. As the box below shows, the problems of running a global company are quite different from those of running a domestic one.

It seems likely that the Japanese companies which invest most abroad will also have to change many of the attitudes that have so far made it difficult for foreigners to penetrate the Japanese market. The biggest effect on the Japanese investment diaspora could yet take place in Japan's backyard.

The five ages of man(agement) . . .

TOKYO



Japanese companies learn to take on the outside world in five stages. At first the company is a straightforward exporter. That has little effect

on its organisation, save that international competitiveness is likely to be given a higher priority.

Next the company will make its first moves as a multinational. It usually shifts marketing and then production overseas. Japanese firms like to do this through joint ventures or greenfield start-ups, rather than through acquisitions. This poses a more complex task for managers, but it is not one that is different in kind from the job of managing a domestic company. Strong control is exerted from head office. Senior managers are Japanese; the rest of the workforce is hired locally.

Problems soon build up even at this early stage. Local managers find their promotions blocked because they do not fit into the job-for-life career structure of Japanese companies. That creates a "two nations" character to Japanese firms abroad—something complained of at Japanese subsidiaries from Singapore to Saskatchewan. It is a problem which has other manifestations: Honda lost a legal case in America for discriminating against women—something it would do without a second thought in Japan.

The next step comes when Japanese companies start buying foreign companies or when their foreign subsidiaries become more than subservient assembly plants. At this point Japanese firms have to change. Running the company from head office is no longer possible. Basic traditions alter, especially the way in which decisions are taken within a company.

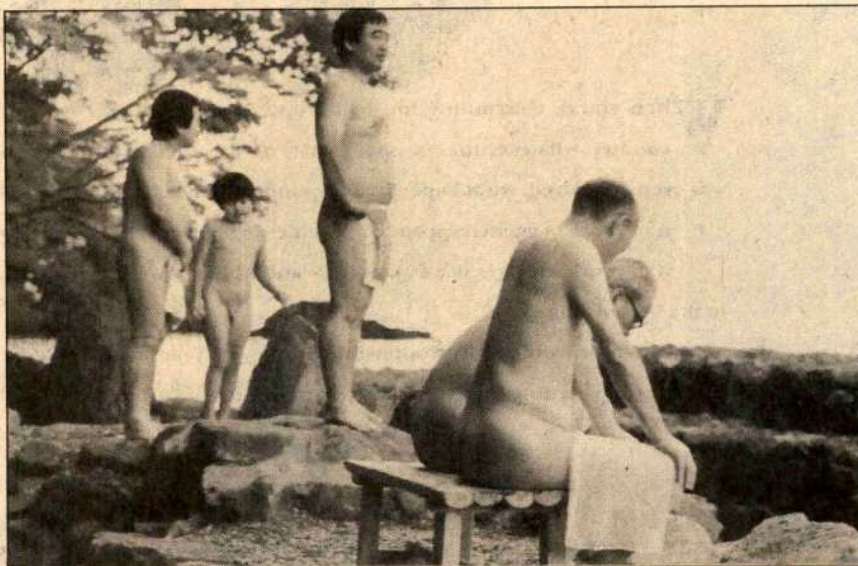
In Japan the first few so-called decision-making meetings are used to nurture a sense of corporate identity and to build

up a consensus, rather than to take decisions. They are routinely attended by managers who have no responsibility for matters on the agenda. This system baffles local non-Japanese managers, and sometimes frustrates them. This causes them to be marked down by their Japanese seniors as unco-operative and untrustworthy. Thereafter their talents are often wasted.

Since this does no one any good, a hybrid company is evolving in America, crossing Japanese and American styles of management. Few better examples of this exist than Honda, US. In Japanese fashion, workers organise themselves into groups to find ways of improving productivity. Good ideas win money and holidays in Japan. But in American fashion, more and more free-wheeling individualism is now being accepted, especially in the design department, which has been responsible for some of the company's latest cars.

Will such a hybrid change the way in which companies operate back home? That will depend upon whether the fourth stage of investment occurs. This is a mirror image of the third: foreigners take over Japanese companies. That will be a slow business. Japan retains its old aversion to mergers and acquisitions. At the moment, therefore, this fourth rarely occurs. But it will have to if there is to be any advance to truly global Japanese companies from which international distinctions have faded: the fifth and final stage.

This is still a long way off. So far, foreign influences on traditional Japanese management are small. Japanese industry is still Japanese. Overseas production accounts for only just over 5% of total production by Japanese firms, against 15-20% for many American and some European countries. Still, even that 5% would not have been expected by most Japanese a decade ago. And already Japan's American subsidiaries are taking their first step back home: 30 of them will export goods to Japan this year.



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An increased final dividend of 8p per share is recommended which, with the interim dividend of 2.5p per share already paid, will total 10.5p per

share for the year (1986 9.5p) – an increase of 10.5%. Shareholders' funds, including retained profits, totalled £593.7 million.

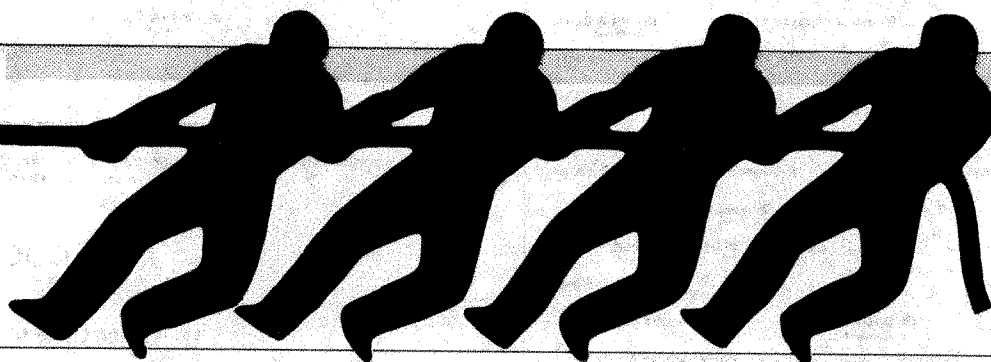
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Thanks are due to our team members and all others connected with our businesses.



HIGHLIGHTS	1987	1986		1987	1986
Turnover	£902.2m	£793.2m	Profit before tax	£73.1m	£57.6m
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FINANCE



The loan star state

NEW YORK

WHILE America's financial markets alternate between worrying about impending recession and rising inflation, they ignore a more imminent problem—the grim and gathering financial storm in Texas. The state is home to two distinct but not unconnected concerns: the banks and the thrifts.

Virtually every bank in Texas has problems. The most dramatic is the state's largest, First Republic of Dallas, which only three years ago was considered its healthiest big bank because it was least exposed to energy. Nobody had given much thought to its property lending.

The Federal Deposit Insurance Corporation (FDIC), the banks' insurance fund, was forced to step in swiftly in March when First Republic reported a first-quarter loss of \$1.5 billion, the second biggest quarterly deficit in American banking history. The FDIC injected \$1 billion and began looking for ways to recapitalise the bank. To prevent the sort of depositor panic which Chicago's Continental Illinois saw in 1984, the FDIC also announced it would guarantee every deposit at the bank, not just those up to the usual \$100,000.

The subsequent loss of deposits at First Republic and other troubled Texan banks has been kept secret. Since March the Dallas Federal Reserve Bank has stopped releas-

ing weekly deposit figures. Mr Ed Hyman, an influential economist at Cyrus J. Lawrence, a New York stockbroking firm, has had a look at the level of borrowed reserves at the Dallas Fed to get some idea. He says

The situation with the Texas banks looks at least as bad as the Continental Illinois crisis. Right now the problem looks to be about \$6 billion compared with the \$7 billion it cost to bail out Continental. That assumes the Texas problem does not get any worse. I think it will get worse because the banks are still losing deposits and interest rates are going up.

Mr Hyman believes that the authorities are dealing with the problem the same way they funded Continental Illinois—by temporarily injecting money into the troubled Texas banks via the Treasury's tax and loan account. They can do this because American taxpayers pay their annual bills to Uncle Sam by April 15th, causing a temporary budget surplus.

Between April 6th and May 13th borrowed reserves at the Dallas Fed declined from \$3.1 billion to \$1.7 billion, reflecting the injection of money from this Treasury account. Mr Hyman guesses that once this temporary budget surplus has been spent, perhaps by the end of May, the borrowed reserves at the Dallas Fed will rise to around \$5 billion. Since First Republic alone has

borrowed \$1 billion from the FDIC, that would mean a total borrowing by Texan banks of \$6 billion.

The recent increase in interest rates (Treasury bond yields have risen in the past three months from 8.3% to 9.3%) is not helping. A similar rise in the cost of money occurred in the months following the depositor panic which nearly pulled down Continental Illinois. Then the borrowing at the Chicago Fed did not peak until September—a four-month lag. If the parallel with Continental holds good, then interest rates could keep rising until First Republic's bankruptcy is formally declared, leading to de facto nationalisation. That should in turn cause interest rates to fall. Financial crises are usually good news for the bond market, in the short term at least.

Though rising interest rates are hurting First Republic and many other fragile banks in Texas, they are even more painful for Texan thrifts. The thrift crisis in Texas is probably worse than the banking one. In May a Dallas-based financial institution, Sunbelt Savings Association, reported a first-quarter loss of \$1.2 billion. Most people on Wall Street did not even know it existed. Sunbelt is not the only disaster. The Texas thrift industry had a positive net worth of \$1.6 billion at the end of 1986. The official negative net worth (assets minus liabilities) of the state's industry at the end of March was \$10.1 billion—nearly equal to the \$10.8 billion borrowing authorised in last year's recapitalisation of the then insolvent Federal Savings and Loan Insurance Corporation (FSLIC). By contrast, the FDIC still has more than \$18 billion in cash even though First Republic could use up a few billion of that.

Sunbelt's losses have come about because, eventually, realistic accounting procedures were forced upon it. A similar nemesis last year led to 96% of the \$1.3 billion of assets of another Dallas thrift, Vernon, being declared non-performing—ie, dud. Unsurprisingly, Vernon closed shop. A lot of other thrifts in Texas still produce accounts that fail to reflect reality. Many of them have made imprudent investments in the local property market. Their problems will grow worse. The property market cannot bottom out until the weakest institutions dump their properties on the market at scrubland prices. Foolish federal subsidies are encouraging banks and thrifts to hold on in the hope of higher property prices. This means, in effect, that both the FDIC and FSLIC are holding long positions on a huge inventory of Texan property assets.

When the cost of all this comes out in the open, it could place great strain on Ameri-

Captain Knapp's log

LOS ANGELES



OUSTED by regulators as chairman of Financial Corporation of America (FCA) in 1984, Mr Charles Knapp is again trying to become a big noise in the mortgage business. His Los Angeles-based Trafalgar Holdings has just bought two small Californian mortgage brokers—Enterprise Funding and Landmark Mortgage—and, he says, would like to buy another 200 or so across America. Mr Knapp has also opened an office in Connecticut to scout the east-coast mortgage market, and is sifting through foreclosed real estate in Texas for bargains.

Mr Knapp has never done things by halves. He built FCA into the biggest sav-

ings and loan company in America, with assets of \$34 billion. That was achieved by betting on shifts in interest rates and a huge increase in loans using hot-money scoured from around the globe—a bet which he spectacularly lost.

Bank regulators, who challenged Mr Knapp's book-keeping, forced him to resign. There was a \$7 billion run on FCA. Although under new management, FCA is still in intensive care and seems headed for either a huge bail-out or liquidation by the Federal Home Loan Bank Board.

Undeterred by that setback, Mr Knapp plans to generate between \$1.5 billion and \$2 billion in mortgage business

this year. Within five years he expects his Trafalgar Capital to be rivalling the mortgage business of the mighty Citicorp. Eventually, he hopes to take the company public.

There are, apparently, still plenty of people around willing to punt on Mr Knapp. Trafalgar says that it has closed transactions on \$1.25 billion in financings and commitments since early 1985 when the company was formed. Overall, says Mr Knapp, it has made some \$3 billion in offers over the past three years backed mainly by a group of British and European investors.

Among his exploits was a pledge in 1985 of \$70m to help Mr Paul Bilzerian, a Californian corporate raider, to take over Cluett Peabody, which makes Arrow shirts. In the same year, Mr Knapp and ten like-minded folk made an unsuccessful bid to snap MGM from the clutches of teletycoon Mr Ted Turner; then he and his investors put their money behind another failure—the attempts by a Wall Street corporate raider, Mr T. Boone Pickens, to buy Unocal, a Californian independent oil company.

Trafalgar's successful deals have been more modest—eg, the funding so far this year of \$325m in mortgages—and have failed to win back for Mr Knapp the power and prestige he enjoyed in his heyday at FCA.

Some of Mr Knapp's executives say that he is tired of taking the rap for the continuing problems at FCA. When recently he hired Mr Lawrence Taggart, a former commissioner of the California department of savings and loans, to head Trafalgar Capital, Mr Knapp also hoped he hired some more credibility.

ca's already rickety federal deposit insurance system. This would precipitate demands for a full-scale bail-out—to be met, of course, by the taxpayer who is not paying enough to meet America's ordinary government expenditure already. The banking crisis in Texas could soon be travelling north to Wall Street.

Bolivia

Doing it by the book

WASHINGTON DC

IT WAS once the worst of all Latin America's basket cases, which is no small boast. But Bolivia's economy has greatly improved. All of a sudden, it is being rewarded by the commercial banks, western donors, the In-

ternational Monetary Fund (IMF), the World Bank and two big oil companies. Other debtors take note.

In 1985 Bolivia's inflation was running at an annual rate of 20,000%. The newly elected president, Mr Victor Paz Estenssoro, and his finance minister, Mr Juan Cariaga, applied the brakes. They told loss-making state enterprises, including those producing tin and oil, to pay their way without subsidies.

Many people lost their jobs in overmanned industries, including 20,000 workers in the tin mines. The government tightened its monetary policy, cut its budget deficit by slashing spending and collecting more taxes, lowered import tariffs, and kept the exchange rate competitive.

Results came quickly. Inflation dropped last year to 11%, and should be about the same this year—one of the lowest rates in Latin America. After six years of decline, real GDP grew last year by 2.2%, and is ex-

pected to grow by 2.5% in 1988. Finance rewards are coming too. Bolivia's 54 commercial-bank creditors, led by Bank of America, allowed it to buy back, at bargain rates, as much of its debt as it could afford to. After a four-month negotiation, Bolivia has bought 48% of the government's \$670m of commercial-bank debt at 11 cents on the dollar. It got the money from a dozen western donors who deposited it in an escrow account at the IMF. The Bolivians now want to buy back the other 52%.

Last week Bolivia signed a letter of intent with the IMF that looks set to produce another first: a credit from the IMF's new Enhanced Structural Adjustment Facility (ESAF), which is intended for poor countries that are striving to correct balance-of-payments difficulties. If approved, the credit will be SDR136m (\$187m), granted on highly preferential terms. The IMF is also likely to give Bolivia a credit of SDR40m from its Compensatory Financing Facility,



From basket case to suitcase

to cushion the stress caused by low world prices for tin, other minerals and natural gas. The IMF asked for no new promises in return. "We have done it all by the book," says Mr Cariaga with pride.

The International Development Association, the soft-loan arm of the World Bank, is expected to approve a \$70m credit to help Bolivia expand its rudimentary financial system. IDA is also financing a \$47m quick-disbursing loan to allow the country to import some of the materials urgently required by its oil, railway and construction industries. Japan is providing a soft loan of \$50m for the same purpose.

In another agreement, the Bolivian government has initialled a novel deal to settle its arrears of \$160m with two oil companies, Occidental and Tesoro. Bolivia says these were built up because Argentina was slow to pay for its imports of Bolivian natural gas. The money will be made available over two years from counter-trade receipts in Argentina, in the form of irrevocable letters of credit. The two oil companies are said to have promised to invest another \$210m in Bolivia by 1992. The agreement covers only natural gas. The two companies are free to repatriate their earnings from oil.

Bolivia's economy ought now to be ready for sustained growth. Some capital that had fled the country is beginning to flow back, as long-battered confidence starts to revive. Foreign investors are being made to feel welcome.

Despite all this, most of Bolivia's people remain dirt-poor. Many have so far seen none of the benefits of the economic turnaround—just the usual hardship and, usually, more of it. The government has launched a public-works programme financed by an Emergency Social Fund,

which the World Bank backs enthusiastically, but this cannot be expected to make much impact. One of Latin America's most successful governments remains, therefore, one of its most unpopular.

Chicago's financial markets

Future imperfect

CHICAGO

OFF the hook for the October stockmarket crash, Chicago's futures and options exchanges are getting down to business as usual. They have two pressing tasks: to re-establish their reputation for innovative financial instruments; and to fight off competition from other international futures and options markets.

The pioneering of new financial products, and the growing trading volumes in stock-index futures and options, came to a halt with the crash. So did the uneasy relations between Chicago's innovative exchanges and the New York Stock Exchange. New York blamed Chicago's trading in stock-index futures for the crash, with no clear evidence to hand, so as to divert attention from New York's own trading methods.

In the past seven months futures exchange officials have been shuttling between Chicago and Washington, DC, defending their products and markets. Barely a week has passed without executives from the Chicago Mercantile Exchange, the Chicago Board of Trade or the Chicago Board Options Exchange (CBOE) descending on the capital and bending the ears of Congressmen and regulators. This intensive lobbying appears to have done the trick, at least on its

first targets. None of the mainly anodyne, post-crash reports has blamed Chicago, and most have shied from proposing tighter regulation of its free-wheeling markets.

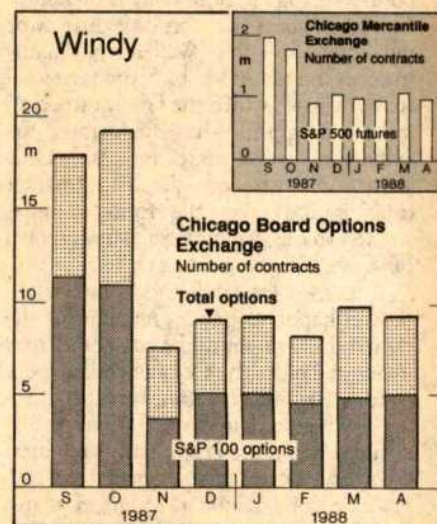
According to Mr Leo Melamed, chairman of the executive committee of the Chicago Mercantile Exchange: "We were busy trying to defend ourselves against demons that did not exist. Now we are going to serve the needs of the investing public and we are going to grow."

That growing will face problems. Since October there has been a fall of more than two-fifths in the volume of trading in the flagship contract of the Chicago Merc—the Standard & Poor's (S&P) 500 future, which is in effect an agreement to purchase the S&P 500 basket of shares for delivery at a future date.

By contrast, fortunately for Chicago's futures traders, old-fashioned commodity futures are seeing their best market in more than five years. Merc traders have been able to turn to cattle and pork-belly futures for their living. And at the rival Chicago Board of Trade diminishing stockpiles of grain and talk of a mid-western drought have meant busy trading in the wheat and soyabean contracts.

The options-exchange traders are not so lucky. Roughly 55% of the total business on the CBOE—9.2m contracts a month—is in S&P 100 stock-index options, compared with 63% out of a total of 17.8m contracts a month before the crash (see chart). The rest is in options on individual stocks where volume has also plummeted as investors deserted the market. That has hit not only traders but the exchange as well. The CBOE is cutting its staff by 20% from its pre-crash levels to around 1,000 through layoffs and, ironically for an exchange only 15-years old, through early retirement. The exchange can now break even on daily volume of 390,000 contracts, or half the business it was doing in September 1987.

The CBOE has learnt the hard way about



Sources: CBOE; Futures Industry Association

the dangers of relying too heavily on one type of product. It is negotiating an agreement with the Chicago Board of Trade to allow trading of stock-index futures on the options floor. It is also having to sell itself harder. Traders have begun visiting brokers

across America to promote what they call "profitable options strategies for a bear market."

The other two exchanges are rethinking their strategies. The Chicago Merc is trimming its plans to trade futures in Japanese

and other international stock indexes. It will also curb the project to open a second trading floor devoted solely to stock-index products, and is ironing out the technical details of its proposed electronic tie-up with the news agency Reuters—dubbed, somewhat

Taking stock home

Sweden's stockmarket discourages foreign investors. Yet its shares are as internationally traded as any. How come?

DESPITE the country's opulence, naked money-making is frowned upon in Sweden: remember the young options trader who was fired for bragging to a newspaper about his champagne lifestyle? Sweden's bratpack should move to London or New York, for that is where the real money in trading Swedish securities is being made.

One reason is that the management of Sweden's youngish securities industry is not yet up to international scratch. Several banks, including two of the largest commercial ones, Svenska Handelsbanken and Götabanken, lost fortunes in the October crash from trading options and futures. They lacked the management and computer systems to monitor the risks their traders were taking.

More important, hefty commissions in Sweden and a turnover tax of 1%, paid by both the buyer and seller in a share transaction, have pushed share trading to freer offshore markets. In London 15 firms make markets in Swedish shares. Before the October crash, trading in them was often five times greater than the volume on the Stockholm bourse. It is still often twice as great.

That might seem odd, given that the shares which foreigners can get hold of are few. Perhaps three-fifths of the Stockholm bourse's capitalisation is in firm hands. Two-fifths alone is controlled, directly or indirectly, by the Wallenberg family (though the recent bid by Stora for Swedish Match—of which the family owned an influential chunk—has highlighted its willingness to sell shares for cash). Only about a fifth of the stockmarket capitalisation takes the form of unrestricted shares, which foreigners can own but have few or no voting rights.

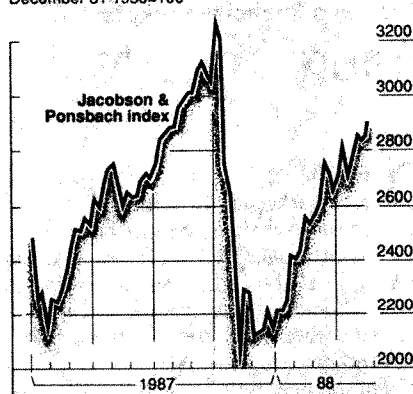
Yet overseas investors have often proved happy to pay a premium for the right to have no say in the companies they invest in. Before the October collapse, unrestricted shares sometimes traded at levels 40% higher than their restricted equivalents. During the crash, such premiums vanished. Foreigners dumped an estimated SKr4.5 billion (\$750m) of shares

MARKET FOCUS

on to the Stockholm bourse in the five months following the crash.

That has not stopped Sweden's stockmarket from rising by 34% this year, the paper and pulp sector by nearly half. Now overseas investors are dipping their toes back into Baltic waters: premiums on unrestricted shares have been creeping up again. Foreigners are afraid to miss out on further rises: between 1980 and last October, the Stockholm bourse climbed by over 400%—among the world's best

Sweden's stockmarket
December 31 1956=100



performers.

Sweden wins its current charms for the overseas investor largely by default. Many managers of European portfolios, who want a stake in northern Scandinavia, think that the Norwegian and Finnish stockmarkets are too small and lack liquidity; and that their economies are not sufficiently diverse. Oil accounts for 40% of Norway's exports; so the depressed oil price threatens balance-of-payments headaches, and a possible currency devaluation this year.

Finland's market has recently reached an all-time high. Forestry products account for 40% of Finland's exports. The price of wood pulp surged last year, and has continued its rise since. Analysts

doubt whether it will rise for much longer. International investors who want a wider exposure to the Finnish economy have only one choice—to buy into Pohjola, an insurance company which is the biggest investor on the Helsinki bourse.

Not that Sweden's economic outlook is perfect. The national system of wage-bargaining is fraying. Local unions are starting to have more success in topping up the wage rises which are agreed centrally. A three-week strike earlier this year by white-collar workers at Volvo, Sweden's main motor manufacturer, depressed that firm's earnings by 26% in the first quarter of 1988. Most analysts predict that corporate profits will grow this year by less than half last year's 16%.

Strong wage demands and buoyant consumer spending are pushing up inflation. In April alone inflation was 0.9%, making it 6.1% in the year; real GDP growth for 1988 is unlikely to exceed 2%, after 2.8% last year.

Nevertheless, many investors are attracted by the so-called "technical" factors of the Stockholm bourse. For example, Swedish companies have heaps of cash, although they have recently been spending a lot of it on takeovers. They argue that they need to grow big in readiness for a post-1992 Europe, and assume the best way of growing is by takeovers at home and overseas. About \$10 billion of such deals have been announced since last September, several by pulp firms such as Stora, MoDo and SCA, which want to expand further out of their traditionally cyclical core businesses.

The coffers of domestic investment institutions are bulging, but they are restrained from investing their cash in overseas securities. They are expected to pour about SKr11 billion of new funds into the stockmarket this year, up from SKr8.3 billion in 1987. That looks quite a bullish "technical factor", and enthusiasts for Sweden refuse to be frightened by last year's crash.

They point to the health of Sweden's foreign earnings. Three-fifths of the profits of Sweden's 30 largest firms, which account for around 60% of Stockholm's market capitalisation, come from exports or from overseas subsidiaries.

uncomfortably, PMT or post-market trading.

This week the Chicago Board of Trade launched a new future on short-term American treasury notes—in an attempt to win business from the New York Cotton Exchange, a soft commodity exchange which began dabbling in financial futures in 1985. After the success of its night session (to coincide with the start of trading in Japan), the Chicago Board is considering a third daily trading session to capture a slice of European business.

While Chicago's exchanges may be squaring up well to fight competition from other markets, they are likely to come under frequent scrutiny in future from regulators and politicians. The House committee on the October crash is still taking evidence, and some Congressmen are still fuming about trading in stock-index futures. Washington seems too pre-occupied with the November presidential election to consider passing any legislation this year that might hurt Chicago's markets. But next year, who knows?

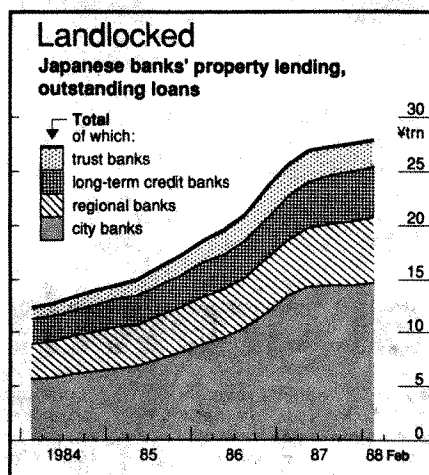
Japanese property So far, Sogo

TOKYO

HOW many tremors are registered before an earthquake? The resignations of the vice-president and two other directors of Dai-ichi Sogo Bank, now under investigation for allegedly making illegal loans to a property company, have revived fears about Japanese banks' heavy lending to finance Tokyo's 1986-87 property boom. The resignations follow the disclosure of unauthorised loans to a property developer by a branch of Japan's biggest commercial bank, Dai-ichi Kangyo (no relation to Dai-ichi Sogo); then the bankruptcy in February of two Tokyo property firms; and then rising arrears by property companies on their bank loans.

So far, according to a senior official at the Bank of Japan, there are no indications that any commercial bank faces difficulties. But the Ministry of Finance and the Bank of Japan have long worried about the banks' rush into the speculative land boom. Last year they ordered the banks to curtail it. This had a clear effect. As the chart shows, bank loans outstanding to property firms had risen from ¥17 trillion (\$87 billion) in January 1986 to ¥27 trillion by July 1987. This was equivalent to an annual growth rate of 35%, before the levelling-out.

The land-price boom has faded too. In Tokyo, where the boom was loudest, commercial land prices have fallen by 4.4% and residential land prices by 7.8% in the year to March 1988, according to the Japan Real Estate Research Institute. Last September the



Source: Bank of Japan

annual rise in property prices had slowed to around 10%. The giddy stuff was in the year up to March 1987 when commercial property rose by 23% and residential by 32%.

Analysts in Tokyo say that it would take a 40% fall in property prices before serious discomfort would be felt by financial institutions, but some banks are clearly worried about the high level of their outstanding property lending. Loans to property firms account for only about 10% of the lending of commercial banks. But add in housing loans to individuals; loans to industrial companies against their undeveloped property assets; and loans as working capital to cover land transaction costs, and the banks' true

exposure to property is at least double that figure.

A lot of this bank lending is concentrated in loans to small property firms, which are most vulnerable to swings in land prices. Bank loans to these companies have increased from ¥14.5 trillion in the fourth quarter of 1985 to ¥23.3 trillion in the fourth quarter of last year; loans to large property companies (which are more able to raise cash through the bond markets) rose from ¥2.3 trillion to ¥3.6 trillion.

Two small property companies, both based in the Tokyo area, went bust in February, Nippon Jutaku Sangyo and Japan Finance. Each had liabilities of over ¥8 billion. Both went under after their bankers refused new loans. In February the bank's bad debts from property were 7% higher than a year earlier, while for Japanese industry as a whole, recovering from the ravages of the high yen, they were 20% lower.

It is also a small property company, Mogami Kosan, that is involved in the Dai-ichi Sogo affair. Here, though, the authorities are investigating a suspected case of fraud, not just imprudent lending. The bank has 28% of its loans—some ¥150 billion—in property, having found ways to dodge the Finance Ministry's guidelines. Some of the bank's top officials are accused of colluding with Mogami Kosan, its main client, to rig the price of a stretch of land in Shinjuku in western Tokyo.

Yenmail and the Japanese raiders

TOKYO

ANYBODY who thinks that, because there are few mergers and acquisitions in Japan, its stockmarkets are free of greenmail is wrong. It is simply harder to spot the racket by which a stockmarket raider buys shares in a company and then strong-arms its management into buying them back at a premium.

In the Japanese way, victims are too embarrassed to admit it but, according to one estimate, 10% of the nearly 2,000 companies listed on the eight Japanese stockmarkets have been bought into by greenmailers. One Japanese brokerage house has listed eight stocks as apparent greenmail targets. They include those of the Matsuzakaya department store group and small retailers such as Chujitsu-ya and Nagasaki-ya.

Another company currently suspected of being a target is Konica, a camera maker. Last month an Osaka-based property company called Nippon Tochi unexpectedly emerged as Konica's largest single shareholder, with a 22% stake.

Last year Nippon Tochi raised eyebrows by buying heavily into Toyota Automatic Loom Works. Nippon Tochi's stake was subsequently repurchased by the target company's parent, Toyota Motor, and Nippon Tochi walked away with a ¥10 billion (\$80m) profit.

The police suspect that *yakuza* (organised crime) is involved in some of the greenmailing; but say that, as long as the shares involved are bought legitimately and nobody complains, there is nothing they can do about it. Stock-exchange authorities take much the same line.

The *yakuza* involved do not seem to be *sokaiya*, who specialise in threatening to disrupt companies' annual general meetings unless paid off and who indulge in other sorts of extortion against listed companies. The gangster greenmailers are thought to be a separate and worse sort of *yakuza*. They use the stockmarket and other financial investments, such as property in the United States, to launder profits from the drugs trade.

Information for Siemens shareholders

International growth continues

In the first six months of the current financial year (1 October 1987 to 31 March 1988) Siemens' international business continued to expand. Following a phase of marked weakness brought on by general economic

conditions, German domestic business recovered slightly in some sectors in the latter part of the period. The first-half net profit margin, like the 1986/87 annual average, was 2.5%.

New orders

Siemens, comprising Siemens AG and its consolidated domestic and foreign companies, recorded £8,833m in new orders during the period under review. This is 3% more than in the first half of the preceding financial year. German domestic orders were still 8% below the previous year's level, but if power plant business is excluded, an increase of 2% results. The value of international orders rose 12% during the period under review.

in £m	1/10/86 to 31/3/87	1/10/87 to 31/3/88	Change
New orders	8,610	8,833	+ 3%
Domestic business	4,016	3,711	- 8%
International business	4,594	5,122	+ 12%

Sales

At £7,592m, Siemens worldwide sales trailed 9% behind the previous year's figures: these, however, included the billing of a nuclear power plant contract. Leaving this major project aside, sales rose 5% (5% in the German home market and 6% abroad). Sales are expected to grow from £16,500m in 1986/87 to about £18,600m by the end of the current financial year.

in £m	1/10/86 to 31/3/87	1/10/87 to 31/3/88	Change
Sales	8,344	7,592	- 9%
Domestic business	4,396	3,426	- 22%
International business	3,948	4,166	+ 6%

Orders in hand

New orders appreciably outpaced sales, both domestically and abroad. Thus orders in hand rose 4% to £17,409m.

in £m	30/9/87	31/3/88	Change
Orders in hand	16,689	17,409	+ 4%
Inventories	7,482	8,054	+ 8%

Employees

At the end of March 1988, Siemens employees worldwide numbered 358,000 (excluding trainees and temporary student workers). This was 1,000 fewer than at the end of the preceding financial year (30 September 1987). While the company's German employee rolls saw a mild reduction, the work force abroad was marginally increased by the consolidation of newly acquired companies. Employment costs rose 2%.

in thousands	30/9/87	31/3/88	Change
Employees	359	358	0%
Domestic operations	229	227	- 1%
International operations	130	131	+ 1%

	1/10/86 to 31/3/87	1/10/87 to 31/3/88	Change
Average number of employees in thousands	360	358	- 1%
Employment costs in £m	3,618	3,685	+ 2%

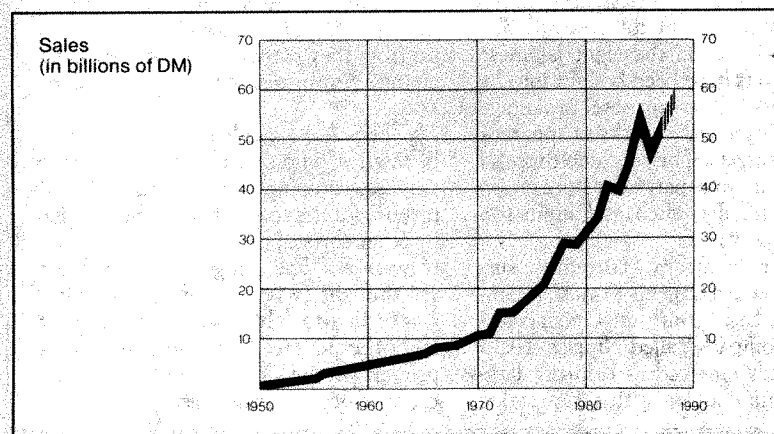
Capital spending and net income

Capital expenditure and investment in the year's first half totalled £627m. This 33% drop was due above all to sharply reduced spending on the acquisition of new companies abroad. It also reflects above-average additions to fixed assets in the same period a year earlier.

Along with sales, net income after taxes fell 9%, reaching £193m. The net profit margin was 2.5%, as for the 1986/87 financial year.

in £m	1/10/86 to 31/3/87	1/10/87 to 31/3/88	Change
Capital expenditure and investment	939	627	- 33%
Net income after taxes	213	193	- 9%
in % of sales	2.6	2.5	

All amounts translated at Frankfurt middle rate on 31/3/1988: £1 = DM 3.119.



Dynamism and growth

In the past forty years, Siemens sales have risen an average of 12% annually – proof of the company's dynamism and growth. Now, Siemens is gearing up for further progress in the nineties with an unstinting commitment of funds to research and development and other capital-intensive investments for the future. The company is a leader in key technologies: microelectronics, data systems and communications technology, factory and process automation, telecommunications, medical engineering, and automobile electronics. Innovative capability, a broad diversity of products, and a company presence in 123 countries – all point to continuing vigorous growth with due allowance for normal economic and currency swings.

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FINANCE BRIEF

A risky business

The market for devices to control companies' exposure to volatile interest rates and exchange rates is booming. Some of the banks that sell these devices are making big profits. But are they taking too many risks themselves?

ONE celebrated eighteenth-century economist, David Ricardo, reckoned that "perfect currencies should be invariable in value". Unfortunately, the values of today's currencies oscillate wildly—to the despair of international companies that want to plan ahead. Interest rates also soar and dive, and never more so than when governments try to hold exchange rates steady.

These uncertainties have fuelled the demand for "financial engineering"—the creation of instruments to limit financial risk. The engineers work mainly for the big banks, in teams grafted on to their treasuries. As the market for these services develops, the banks' customers are becoming more choosy. Many want the best of both worlds: to shelter their profits against storms, but still have a chance to profit from winds blowing in a favourable direction. To meet this demand, banks invent risk-packages, tailored to each customer's needs. Then, as a rule, the banks themselves take on the risks their customers want to shed—for a fee.

The oldest—and least subtle—instruments allowing companies to reduce uncertainty about future income are **forward agreements** for currencies

and interest rates. Forward contracts let companies buy or sell currencies at a pre-set rate; forward rate agreements (FRAs) tie a company into borrowing or depositing money at a certain interest rate. Both sorts of contract come into effect on a set date.

Swaps, in contrast, deal with continuing flows of cash. For instance, a borrower might swap the floating-rate payments due on one of his debts for the fixed-rate payments due on a debt contracted by somebody else. Unless superseded by another transaction, a swap like that would stay in force until the debts were repaid. Last year more than \$500 billion of dollar interest-rate swaps were initiated. In this business—as with all the different sorts of forward contracts—the banks are competing on price. They are selling a commodity.

Such methods limit a company's exposure to adverse movements in currencies and interest rates, but they can also mean missing out on favourable ones. On February 23rd, for instance, an American company could have fixed a sterling payment due to it in three months' time at a rate of \$1.75. By May 23rd sterling was worth \$1.87 on the spot market. Locking in to the lower rate meant less risk, but it also

meant forgoing a windfall gain.

Financial engineers are therefore keen on **options**. For a premium (an up-front fee), the customer buys the right—but not the obligation—to trade with the bank at a specific "strike price". So on May 24th the same American company could have bought an option enabling it to buy dollars at \$1.87 on August 24th from the Midland Bank, a British clearer, for a premium of 1.85% of the contract value. The company would exercise the option if sterling fell below the strike price (and it would show a profit if sterling fell below \$1.84—the strike price less the premium). Thus the option provides insurance against a fall in sterling, while allowing the gains from any rise in sterling to be collected.

This way of taming risk has proved popular. In a recent survey of American companies by the Whitney Group, a headhunter based in New York, 85% used currency options; but only 37½% had entered into long-term currency swaps and 12% into foreign-exchange FRAs.

Optional extras

Some treasurers think that a straightforward option is an embarrassingly expensive form of insurance. So the fastest-growing versions of options are those that do not appear to cost anything. The customer trades some of the advantages of rates moving in its direction in return for setting a limit on the worst outcome. The effect is to create a **collar** that sets an upper limit on both gain and loss.

Since 1985 Salomon Brothers, a New York investment bank, has sold \$25 billion-worth of col-

lars known as **range forwards** and **participating forwards**. Here is how they work:

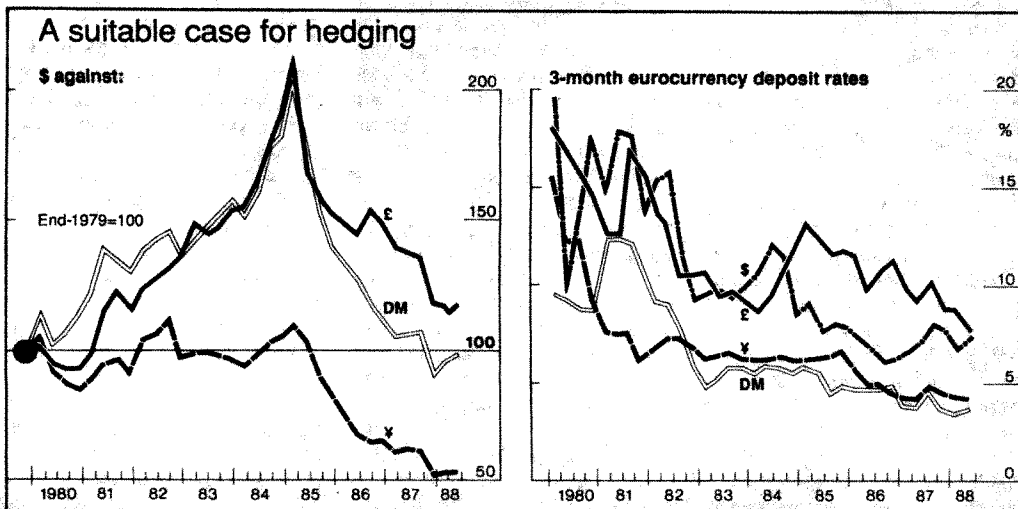
- With a range forward a customer sells Salomon one option and buys back another. The premiums cancel out but the contracts have different strike prices. The gap between those prices becomes the range forward. For example, on January 4th, the first trading day of 1988, when the dollar was worth ¥121, Salomon offered a range for one year ahead of ¥125-110 to the dollar. So a client due to receive a known amount of yen on January 4th 1989 could put a floor on his future exchange rate of ¥125, but would lose out on any better rate than ¥110.

- A participating forward also carries no premium, and also limits a client's worst case to a certain rate—say ¥125 to the dollar for the same exposure as above. This time, though, Salomon does not cap the customer's best outcome. Instead the bank pockets 30% of any movement in the client's favour.

Option-cocktails, like the quaffable varieties, have exotic names. Goldman Sachs's version of the range forward is the "min-max", Citicorp's the "cylinder". A recent directory in *Risk*, a trade journal, showed over 50 banks offering nearly 70 different products. All of them have similar functions. But by combining the same basic ingredients in different ways the banks can offer cocktails to the customer's precise specification. That means a bigger fee.

The most sophisticated customers have learned how to unravel the ingredients and are selling options themselves. Some big corporate firms like British Petroleum treat their treasuries as profit centres, and are as aggressive as small banks. Goldman Sachs says that its London office buys as many options from customers as it sells.

Only a cluster of banks (Goldman Sachs, Citicorp, Morgan Guaranty, First Chicago and Morgan Stanley from America; Midland and Barclays from Britain; and France's Banque Indosuez) make markets in currency options in America, Europe and Japan. But deals are often brought in by other banks. Goldman Sachs in London, for example, has a list of over 200 customer banks with smaller options departments which use its prices to quote to their own



customers.

Interest-rate collars work in the same way as their currency counterparts. The customer knows that over a specified period he will be able to borrow at the collar's upper rate even if market rates have moved higher, in return for having to pay the lower rate even if market rates have fallen below it. American companies making big debt-financed takeovers have used collars to control their repayments. Big sovereign borrowers like Brazil have also looked at these techniques.

Business is booming in foreign-exchange and interest-rate options. The banks are not the only ones to prosper. The options exchanges in London, Philadelphia and Chicago are also doing well. They sell tradable options-contracts for fixed amounts on certain dates: at the end of 1987 1.4m interest-rate



Pre-engineer Ricardo

options (almost a threefold increase in 1986) and 805,000 currency options (a 50% rise) were outstanding on American exchanges alone.

Bankers think that the off-exchange business they run is growing even faster. They estimate that, including interbank transactions, they now handle \$10 billion-worth of foreign-exchange option transactions each day and a further \$500m in interest-rate options. Volumes in both markets have doubled in the past two years. Roughly 20% of currency-option transactions are initiated by non-bank clients, about four times the proportion in the spot and forward ex-

change markets.

The market still has room to grow. Tokyo, for instance, is about two years behind London and New York, according to Goldman Sachs. Likewise, although most big companies use options of some sort, pension funds and other institutions are still novices. Many mutual funds in America are banned from using options by their own by-laws. But the biggest potential market is the Japanese life insurance companies. According to some (disputed) estimates, these have lost ¥2 trillion on their enormous American government-bond portfolios through currency depreciation.

Where's the catch?

Even bankers admit that making money in options is risky. Financial engineers cannot earn their keep on the small dealing spreads between premiums—though these are usually four times wider than on normal foreign-exchange transactions. Most of the banks' profits come from taking on the risk that their customers wanted to get rid of. So profits from options-trading are often erratic.

Take the example of Mr Andy Kreiger, a currency-options trader at Bankers Trust, a large New York bank. According to his envious rivals, his trades were so large that he moved prices in some of the smaller foreign-exchange markets such as Australian and New Zealand dollars so far that the central banks of those countries complained.

In the last three months of 1987 Bankers Trust made profits of \$338m from foreign-exchange trading, more than it had made in the six years up till 1986, when Mr Kreiger joined its team. On February 25th Mr Kreiger resigned—supposedly out of disgust at receiving a bonus of only \$2m. In the first quarter of 1988 Bankers Trust lost \$19m on foreign-exchange trading. The problems of unravelling the hundreds of complicated open positions built up by Mr Kreiger were partly to blame.

All the biggest banks admit that they have known losses of over \$1m in one day in currency options. In 1985 and 1986 Bank of Credit and Commerce International, a privately owned Arab bank, lost more than \$200m through interest-rate options.

Options produce such violent results because they are super-

Running dogs

The market for financial engineering has thrown together some unlikely bedfellows. Alongside some of the most aggressive capitalists in the world, such as Mr Kreiger, sit some of Britain's most left-wing local-government councils. These profligate town halls have had their rates (ie, local taxes) "capped" by the central government, and are therefore topping up their resources in other ways. They have discovered that there is money to be made in writing "swaptions"—complicated options to take part in interest-rate swaps.

Brent Council, for instance, has picked up around £2m for writing such options. They give the banks the right in March 1990 to force the council into five-year swaps on loans worth £50m. If the swaptions are exercised the council will pay the bank floating-rate interest pegged to the London Interbank Offered Rate (LIBOR) while it receives fixed interest payments of around 9.2%.

So if LIBOR (currently at 8.25%) rises above 9.2%, the banks will exercise the options. If LIBOR jumps to, say, 12%, the swap will cost the council £1.4m a year. Brent says that it will buy the option back if that happens—difficult if, in the meantime, it has spent the premium.

Ratepayers in Brent may have another fear: some major banks are starting to be sniffy about taking on the credit risk of dealing with left-wing councils. That has left room for one of the better-off (and more moderate) local councils, Richmond, to generate extra cash by acting as an intermediary. Richmond admits that it runs a risk if its neighbours default, but says the business is profitable. In the meantime, like Brent, it is betting ratepayers' money that Mrs Thatcher's government will keep British interest rates low.

sensitive. Suppose a trader buys \$1m-worth of D-marks. Even if the D-mark depreciates overnight by 10%, they will still be worth \$900,000. If he bought \$1m-worth of options to buy D-marks in a year's time, then a mere 5% rise (or fall) in the exchange rate might be enough to double (or halve) his investment.

The steepest losses come from selling options not buying them. Such losses are in theory limitless, so banks try to hedge the greater part of their exposure.

Options involve two sorts of exposure. The first arises from the difference between the option's strike price and the corresponding price in the cash market. It affects the profit or loss that will be incurred if the option is taken up. This exposure can be calculated with certainty—and fully hedged—at any point in time. The bank buys or sells enough of the relevant currency in the cash market to offset its future exposure; every time the market moves, the bank re-adjusts its position until the option eventually expires.

The second sort of exposure arises from volatility in the spot market, which controls the probability that the option will be

taken up at some future time. This exposure is impossible to measure. It can be accurately calculated only on a historical basis—when the option has expired (ie, too late). In order both to price and to hedge options, banks look at the historic volatility of the cash market and then guess what the future volatility will be. With computers to do the number-crunching, the banks then create an offsetting exposure by selling (or buying) more options.

Perplexing though this looks, it is only a beginner's course in option-hedging. Experts like Mr Kreiger take more complicated routes, hedging and positioning themselves across a range of currencies and interest rates, all with different volatilities.

Given the complexity of option-hedging, should companies that lack banks' computer power sell options? The danger is greatest when a poorly equipped investor writes an option while lacking a position in the underlying cash market. Bankers call this "naked" option writing—ie, high-stakes gambling. Undoubtedly, David Ricardo would have preferred stable money.

SCIENCE AND TECHNOLOGY

Clearing the air on genetic pollution

EVER since biotechnologists learnt how to play with genes, onlookers have worried about the playthings escaping. A dozen genetically engineered bacteria, viruses and plants have been intentionally released into the wild, and 20 more field tests are waiting in the wings. So far no disasters have been reported. But pessimists point out that even "the chances of genetic pollution are small, consequences could be far-reaching. It is time for new light on what has become a stale argument.

Consider first the historical precedents (which, some will be surprised to hear, do exist). Around 1,400 foreign insect species successfully spread to America between the mid-seventeenth century and 1977. One-fifth of them are reckoned to have done some good (such as eating other things which were worse); two-fifths turned out to be minor pests; another fifth seemed to pass unnoticed; but the last fifth are reckoned to have damaged their new habitats severely. (One example is the Gypsy Moth, which was accidentally transported from France to Massachusetts in the 1860s.)

Or consider plants. America's Department of Agriculture reckons that in 1982-86 some 8,000 new plant species were introduced to America each year. About 80% of them were barely noticed. About 10% proved to be valuable crops. A small number, such as Johnson grass, water hyacinth and veronica, turned out to be mischievous.

Exotic species tend to run amok because the local predators are not used to them. Some reproduce uncontrollably because, unlike their competitors, they can flourish on many different foods. But genetically engineered organisms are different. According to an analysis published this month by the Office of Technology Assessment (OTA) in Washington, DC, most of them closely resemble their normal neighbours. They differ from them by only one or two genes. Such a small difference will not be noticed by predators, who will eat them all the same. (An exotic organism, by contrast, may bring as many as 20,000 foreign genes into its new home.) Also, an engineered organism is

more likely to die off than to dominate its new habitat. When new genes are put into an organism it usually gets worse at turning food into energy.

Despite these reassuring points, a newly introduced gene could still upset the environment. Take the *Bacillus thuringiensis* (BT) toxin, the gene for which has been inserted into a number of plants to make them unattractive to scavenging caterpillars. The toxin is commonly used in large quantities to kill off moths, beetles and butterflies. So far it has been regarded as harm-



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less because it does not hurt animals or humans and it decomposes rapidly when left unprotected. But it could have a longer active life in the protected surroundings of a plant. That might give caterpillars time to develop resistance to the poison.

Similarly, efforts to increase the uptake of nitrogen in some plants by genetic means could limit supplies of the nutrient to its neighbours. Greenhouse tests conducted by Biotechnica International in Cambridge, Massachusetts, have shown that its genetically engineered *Rhizobium melioli*—a microbe that lives on the roots of alfalfa plants—snaffles up to 17% more nitrogen from the air than ordinary *Rhizobia*. However, natural *Rhizobia* in an acre of alfalfa

gather 45-90 kilograms of nitrogen from the air every year, and there are 15 tonnes of nitrogen above every acre of land on earth. So this is not much of a threat.

What if genetically engineered organisms were to romp out of their habitat, or if their new genes somehow jumped into other living things? Because only a few genes are introduced at any one time, it is possible to monitor the progress of new genes and find out how frisky they are. Monsanto, an American chemical firm, together with scientists at Clemson University in South Carolina, has devised a way to monitor the movement of recombinant microbes among the billions of other microbes that live in each gram of soil. They have inserted two "markers" into the chromosomes of a soil-bacterium, *Pseudomonas fluorescens*: (1) the so-called lac ZY gene, which enables the bacterium to digest lactose; and (2) a marker which makes the bacterium turn a brilliant blue in the presence of a sugar dye. Recent field tests with the bacteria showed that they never moved more than seven inches away from the wheat-roots that were originally inoculated with the bugs.

Although nobody is sure yet, it seems that genes rarely move from one animal or plant species to another. Bacteria can swap genetic information more easily between themselves (which is why they can quickly develop resistance to antibiotics). Plasmids, self-replicating loops of genetic material that float around within a bacterium, can sometimes transmit themselves between similar cells.

So a number of biotechnology firms are trying to develop "suicidal" bacteria that carry inert or self-destructing plasmids which will be incapable of passing on their genetic information to other micro-organisms.

America's Environmental Protection Agency has made a kamikaze plasmid that does its job and then expires. It self-destructs when the toxic waste it is designed to clean up is all gone.

All in all, the OTA thinks that the present activities of biotechnologists give little cause for alarm; and that none of the modest field tests proposed for the next few years is likely to result in an environment gone haywire. The agency makes an obvious but telling point against the over-cautious: field tests are a much more reliable guide to the risks of biotechnology than experiments in greenhouses or other safe, but uninformative, environments.

Japan's big nebulous idea

Which way to the frontier?

TOKYO

JAPAN has an unenviable reputation as a technological leech. It does little basic research: of the 3% of its GNP spent on research and development a relatively low 12% goes on as-yet-uncommercial science. It is a net exporter of students: there are around ten times as many Japanese on American science campuses than *vice versa*. And Japan spends four times more each year buying American technology than America manages to wrinkle out of Japan.

Most of this imbalance appears to be due to a lack of interest in Japanese ideas on the part of Americans. But such excuses do not impress the xenophobes. Americans of protectionist bent—Senator Jay Rockefeller of West Virginia and Senator Robert Dole of Kansas are prominent among them—have come to believe that Japan is getting a cheap ride to trade surpluses. Nothing new there: such claims were already a worry for Mr Yasuhiro Nakasone, the then prime minister, in 1984. That was when he came up with the idea that has become the Human Frontier Science Programme—a way to spend huge amounts of money on basic research in a pleasingly noticeable way.

The programme was to be largely biological—showing that the Japanese do not just think about computer chips and video-recorders—and its results would be bounteously distributed to all and sundry. The Japanese were content to organise the show (though they wanted some of the money to come from Europe and America). Yet grants from the project would not be restricted to scientists in the countries that paid. It could become the world's first truly international governmental research programme. And the world would have to thank Japan.

Such, at least, were the first proposals, as supplied by the Agency of Industrial Science and Technology, an offshoot of the powerful Ministry of International Trade and Industry (MITI), in February 1986. It suggested that ¥1 trillion (\$5.6 billion then), half of it from Japan, be spent over 20 years.

Like most attempts to demonstrate good-will to the world, there is less to the Japanese project than meets the eye. The version now being touted is much less ambitious, and still has no assurance of getting under way. The project got an approving nod at the Venice economic summit of rich countries last year, and Japan hopes it will be on the agenda next month at a similar gathering in Toronto. A feasibility study has just been published. There have been conferences and rumours of conferences. But there is still precious little money, and not a whiff of science.

The latest feasibility study proposes a system of research grants, fellowships and workshops adding up at most \$100m a year. (For comparison, the Massachusetts Institute of Technology's budget in the year to July will be around \$1 billion.) That money is to be spent on harnessing the "diverse and exquisite functions of living organisms" to expand human technologies—a cause all good men can rally around, but an insubstantial foundation for a research plan.

The subjects selected for study are the brain—especially its ways of visualising objects and understanding words—and investigations of biological molecules that might yield tips about agriculture, as well as medicine. It seems that no attempt has yet been made to hone these huge areas down to size. Selection will end up as a matter of case-by-case haggling in front of review panels: a good formula for endless rows, and a bad one for any sense of purpose.

Will the programme ever get off the ground? The other potential donors would prefer to see Japan using its money as well as its mouth, and running the programme alone for three-five years. Yet the programme's proponents, MITI and the Science and Technology Agency, may not be able to afford it. Certainly they will make no grants under the programme in the current fiscal year (which ends next March). If any are to be given in the following year, the agencies will have to make a budget request sometime this December. And since they operate under the "negative ceiling" principle (all budget requests, except those for defence or overseas aid, must fall in real terms), a budget for the human-frontier programme will mean squeezes and cuts elsewhere.

Officials say they will be asking for "several billion" yen (¥1 billion is now worth \$8m). They calculate that the scheme might get no more than

\$50m a year—or less, if enthusiasm is muted on the other side of the Pacific. That will not make much of a splash in well-trodden areas of science that are already absorbing many of the world's best researchers and most science-minded companies. Nor will it pacify Senator Rockefeller and his ilk.

Neutron stars

Spinning faster in their graves

FOR stars, at least, there is an after-life of sorts. After billions of years of life, there comes a time when a star finds that nuclear fusion can no longer support it at the size to which it has become accustomed, and so it collapses. What is left behind depends on the size of the star. Small stars, like the sun leave white dwarfs. The biggest leave black holes. Those of intermediate size have neutron stars to mark their graves.

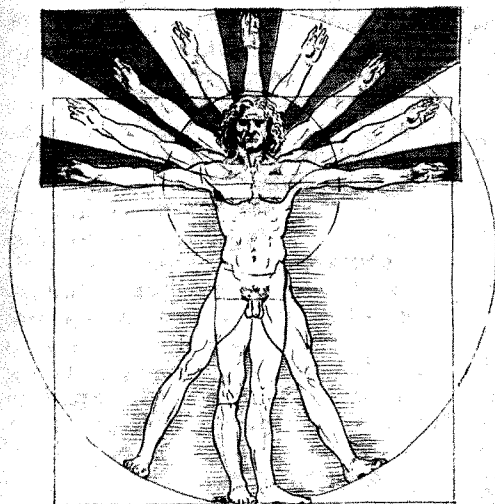
A neutron star is a tiny tombstone: only 20 kilometres or so across. But much of the star lives on in it. Forcing the properties of a large star into such a small space will necessarily exaggerate them. The neutron star's magnetic field is a million million times stronger than the original star's. It spins every few seconds, not every few weeks. And it is inordinately heavy: a cricket ball made of the same stuff would weigh 20 billion tonnes.

As the neutron star turns, its magnetic field can spray a beam of radiation across the sky. From the earth, such active neutron stars (the only ones that can be seen) appear to flash on and off like lighthouses every few seconds. Astronomers call them pulsars.

Such stellar after-life is not eternal. The beams that make a pulsar visible are driven by the interaction of its magnetic field and its spin. As the star radiates its energy away, it slows down, so the beams get weaker. The magnetic field fades as the electric currents trapped in the surface of the star stop circulating. With less spin and less field, the pulsar stops pulsing.

Yet it does not stop moving. The death throes of the original star are usually lopsided, which means that the neutron star can emerge from the flames with a speed of up to 200km a second. So it is possible to judge the age of a neutron star by how far it has strayed from the plane of the galaxy (where most of the explosions that spawn neutron stars are to be found). That allows astronomers to study the way they fade.

As they wander in the dark, lonely and beamless, some faded neutron stars get a second chance—they can be born again. During their travels, they may come across a normal healthy star. As they pass, the neutron star's gravity raises a tide on the surface



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of the other star. That costs the neutron star energy, and may slow it down enough to let it go into orbit around the other star. Such a neutron star will follow a comet-like path, spending a little of each orbit close to its new companion, and most of the time far away.

At each close encounter the neutron star will lose some speed. Its orbit will change, until eventually it may be almost circular. If it gets close enough, its tides will pull matter completely free of the companion's surface, so that it rains down upon the neutron star. Like a vampire, the pulsar rises from the dead by sucking the life-force (in this case, angular momentum) from an innocent; eventually it may spin 100 times more quickly than it first did. Much the same can happen if the neutron star was born orbiting a companion. The fast spin, together with the remaining weak magnetic field, produces a beam which pans across the sky in a matter of milliseconds—hence the tag “millisecond pulsar”.

Because their magnetic fields are relatively weak, millisecond pulsars do not radiate away their energy very fast—their second lives are far longer than their first. They also spin regularly—young pulsars are subject to “starquakes”, which disturb the rhythm of the pulses. The fastest pulsar, PSR1937+21, a mass as big as the sun spinning more than 600 times every second, is the most accurate clock known to science. If its gentle slowing down is taken into account, it is accurate to within a second every 3m years. That sort of timekeeping could make it a useful experimental tool.

Since the discovery of PSR1937+21 in 1982, the ranks of the millisecond pulsars have swollen to six. Four of them have companion stars, as you would expect. But PSR1937+21 is companionless, as is one other. Whatever gave them their spin has since vanished.

The most recently discovered of them, PSR1957+20, is the second fastest and may explain how its two brethren lost their companions. It is definitely not alone; for 50 minutes of every nine-hour orbit, it is hidden behind a companion. The companion is large, perhaps three-quarters of the diameter of the sun. But it is puzzlingly light—only 2% of the mass of the sun.

Its discoverers—Dr Andrew Fruchter, Dr Daniel Stinebring and Dr Joseph Taylor, at Princeton University in New Jersey—think that the companion has been almost entirely eaten by the pulsar (hence its small mass and the pulsar's speed). It looks big now because radiation from the pulsar is making it evaporate, turning the left-overs into an opaque cloud of gas. If things go on as they are at present, it will be completely gone some 10m-100m years from now, and PSR1957+20 will be companionless. After this resurrection, it can look forward to a few billion years of long, if lonely, old age.

Seaweed in your champagne, sir?



Twisting the day away

A HUNDRED feet under the house of Moët & Chandon at 20 avenue de Champagne in Epernay, 80 men spend every day twisting 50,000 champagne bottles each. Some simple chemistry, discovered in 1978, is now well on the way to making sure that their sons do not follow them into wrist-wrenching tedium.

Champagne is bubbly because it is fermented not once but twice—the second time inside the bottle. The bottles are filled with wine already fermented; then yeast and sugar are added. The second fermentation soon follows. It produces fizz, more alcohol and a powdery deposit of dead yeast cells, which has to be removed before the wine can be sold. How? Put the bottle in a wooden holder called a *pupitre*, and twist it a quarter-turn horizontally and a few degrees further downwards every few days. After six weeks or so, when the neck will point downwards, the sediment will have collected there. Freeze the neck, expel the gritty frozen pellet, then recork.

This way of clearing the sediment, called *remuage*, is generous with time; it also takes up half of Moët's cellar-space. A decade ago a team of three researchers led by Mr Charles Divies, a professor at the French national institute of agronomic research at Dijon, discovered a way to bring on the second fermentation without leaving sediment, thus rendering *remuage* unnecessary.

Instead of being poured into the bottle in solution, the yeast can be encased in a 3mm bead consisting of an alginate (a useful long molecule found in seaweed). The pores in the bead are large enough for wine to get in, but small enough to stop dead yeast cells getting out: *ergo*, no sediment. The beads can be expelled in the normal way after pointing the bottle downwards for half a minute.

Moët & Chandon bought a 15-year licence to the patent in 1981, and has been testing it ever since, together with the Oenological Institute of Champagne. It is refining the production process for the beads, which are now made by dropping a mixture of alginate and yeast through a syringe into calcium-chloride solution. Pilot production with this new method has just begun, and will rise to at least 25,000 bottles—a thousandth of Moët's usual annual output—by 1990.

None of them will be sold. Wine made by the new method will not be let loose on customers for at least another five years because Moët wants to compare the new wine with the traditional one as it gets older, and to try out different vintages. When it does emerge, the new wine will not be labelled differently.

Mr Edmund Penning-Rowsell, the *Financial Times*'s wine columnist, reckons the traditional wine “seemed to have slightly more bouquet, and was perhaps a shade more complete. On the other hand the ‘bead’ one had a slightly bigger flavour and perhaps was rather less forward.” That apart, he (and other wine buffs) can find no objectionable difference in their tastes.

The toughest test for the new technique will be to persuade buyers, who have been told for years that champagne's superiority lies in its method rather than in its grapes, that some aspects of the time-honoured art are dispensable. Other champagne houses are already interested in the new method. (Mr Philippe Coulon, Moët's chief oenologist, whom the firm values so highly that he travels in a separate aircraft from the rest of the staff, declines to say which.) Some—particularly the smaller and snootier houses—will no doubt keep up their laborious rites.

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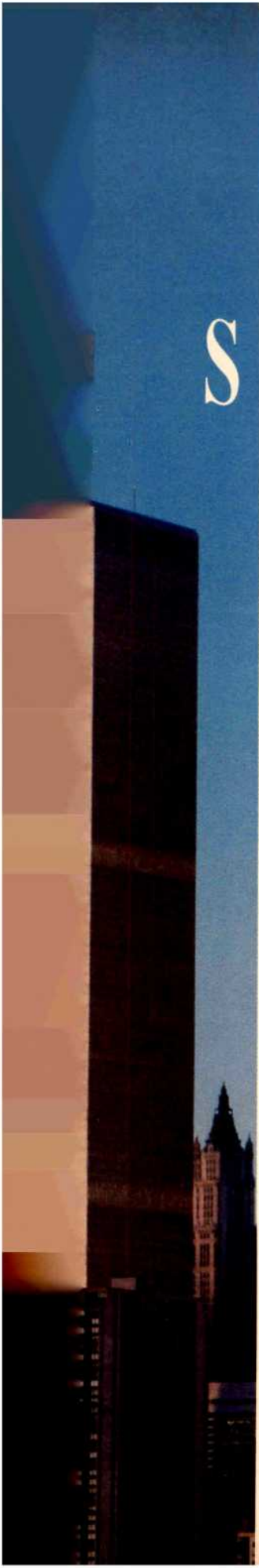
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BOOKS AND ARTS



Will it take inflation to set the debtors free?

THE DEBT THREAT. By Tim Congdon. Basil Blackwell; 246 pages; £25 (£7.95 paper) and \$24.95

MOST popular discussion of "debt" and the financial distress it can cause is at root a debate between two blind prejudices. One of these is that debt is a vice. Peo- countries and governments should live in their means, for "borrowing dulls the edge of husbandry". The alternative view is that a loan freely contracted between consenting parties has the blessing of market forces. Debts—private ones, at any rate—are therefore a symptom of nothing more worrying than the efficient allocation of resources. According to taste, then, debt is something you either moralise about or largely ignore.

Thanks especially to the developing-country debt "crisis" and the recent "explosion" of various sorts of American debt, the moralisers have undoubtedly had the upper hand of late. All that easy credit is finally getting its just deserts. Latin America is paying for its years of profligacy; in last October's crash America received a preliminary slap on the wrist for its own lack of financial self-restraint. This way of thinking need not linger over tiresome distinctions between different sorts of debt. Why worry whether

it is public or private, external or domestic, fixed-rate or floating, secured against assets or otherwise? Debt, filthy stuff, is debt.

Mr Tim Congdon, the chief economist at Shearson Lehman in London, seems at first to be offering a standard-issue rant along these lines. The stark black and red cover of his book instantly gives that impression, as does its title; and his first sentence is hardly encouraging. "This book is self-consciously and deliberately alarmist," it says. But what follows—and it will come as no surprise to those familiar with Mr Congdon's work—is a clear and well balanced study of debt in all its main forms. The book gives due weight to different sorts of debt and to the different sorts of trouble they can cause. At the same time, though, it finds a theme which ties these strands together and which, without being alarmist, is suitably alarming.

The first chapter states a simple rule—a tautology, in fact—which is later applied to all manner of debt. Suppose a debtor faces an interest rate higher than the growth of his income in money terms, and that he spends nothing on net debt service; his debt

must then grow continuously in relation to his income, without arithmetical limit. In practice, of course, debt could not grow faster than income indefinitely. Before long lending would stop and the debtor would be bankrupt. A persistent gap between interest rates and income growth therefore serves warning of insolvency. This basic rule applies not just to people, but also to companies, governments and countries. It also remains true when expressed in inflation-adjusted terms: if the real interest rate exceeds the growth of real income, the debt-income ratio will keep on rising.

It is a short step from this rule to pinning the blame for the assorted debt troubles of the 1980s on high interest rates. During most of the 1970s America's rate of economic growth was comfortably higher than its real interest rate. The ratio of domestic debt to income stayed roughly constant at a little under 140%; it had ranged between 130% and 140% since the early 1950s. But after 1979, when Mr Paul Volcker sharply tightened the Federal Reserve's monetary policy, real interest rates soared. At precisely the same time, America's ratio of domestic debt to income began to rise. Eight years later it is 180% and still rising.

To apply this approach to the foreign-currency debts of the developing countries, "income" must be redefined to mean export earnings. The rule can also be applied to the debts America owes to foreigners—though Mr Congdon gives this issue surprisingly little space. In each case the analysis is similar. The world's lurch towards high real interest rates brought on the developing-country debt crisis, just as it raised Americans' debts to each other and to foreigners. What had seemed prudent at the low or negative real interest rates suddenly seemed reckless. The capital market's failure was that it did not anticipate a historically outlandish rise in interest rates.

Recall that Mr Congdon's tautology breaks down if debtors manage to service their debts at least partly from their own resources, instead of through extra borrowing. Painfully and under protest, the developing-country debtors have been doing this, and are therefore in sight of reducing their debt-income ratios. Correspondingly, rich-country governments can escape their domestic-currency debt traps by running a budget surplus excluding interest payments (often called a "primary surplus"). America's government, for one, is still far from doing so. Meanwhile, interest rates are rising.

What will happen if the borrowers fail to achieve surpluses of income over spend-

Crying into their beer

SINCE the sorry affair of Latin America's debt burst on the world in 1982, there has been no shortage of suggestions for dealing with it. The most radical of all is default. In *THE DEBT SQUADS**, Sue Branford and Bernardo Kucinski run through the financial history of the 1980s in an attempt to justify default in moral terms. The authors point out that the governments of Latin America borrowed the money to invest abroad, to steal and to pay interest. Not much went into hard projects, and the people were not consulted. Why, then, should they pay? On the other hand, can a government default and then point to its own dishonesty and incompetence as reasons for doing so?

In the end, the authors build their moral case on external causes: for example, the fearful nature of floating interest rates. It is darkly hinted that on the days when Latin American interest payments are fixed, the banks arrange for the LIBOR (London Interbank Offered Rate) to be jacked up for a few minutes. The White

House, Milton Friedman, the United States Treasury and a host of others are dragged in as the guilty parties who have caused Latin America to "lose a decade". *The Economist* is described as "the magazine which represents international capital".

The authors deride the view that it has been a case of "stupid banks lending to stupid governments", but they fail to rebut it. They also ignore the punishment that the banks have suffered as a result. It is no use pointing to BankAmerica as a ringleader in a subtle and successful plot if BankAmerica is now in trouble itself.

The fundamental problem is the nature of the Latin American state and its overblown role in the economy. Suppose, in the 1970s, that the only large potential borrowers in the continent had been an independent, self-reliant group of capitalists. Three things could have happened: the money would have been well invested and the loans would now be being serviced; the companies would have gone

bust and the banks would have lost their money; or, most likely, it would never have been lent in the first place. The authors allege that government guarantees on the debt were "flimsy"—so flimsy that the governments are now responsible for two-thirds of it. And here the issue may be summed up in Walter Wriston's celebrated remark, to the effect that governments do not go bankrupt. For the banks, this was a licence to forget the link between the money that was lent and the use to which it was put.

Latin Americans do not want the incompetent, powerful state to go away. More nationalisation measures are being voted through in Brasilia. The first edition of this book is much acclaimed by the intellectuals of Rio de Janeiro. But, as they say in Rio, "O intelectual não va à praia, mas bebe"—"the intellectual doesn't go to the beach, but drinks." The prevailing mood of bibulous self pity needs to be replaced by some hard thinking about why the problems of Latin America have not been repeated in Asia.

Zed Books; 142 pages; £6.95

ing? Again Mr Congdon differs from the moralisers. He foresees no cataclysm. Broadly, he believes that governments have learned enough—and have created the necessary institutions—to break most of the links between financial collapse and depression. The real danger is that they will do this in a way that fuels inflation. Heavy public spending to cope with defaults—as many propose for third-world debt, and as is happening already through America's federal system for insuring deposits—may lead in due course to the printing presses. Inflation, not worldwide depression, could turn out to be the real debt threat.

Richard Branson

Lark ascending

RICHARD BRANSON: THE INSIDE STORY. By Mick Brown. Michael Joseph; 278 pages; £12.95

AT LEAST one business school has been trying to find out what makes Richard Branson tick. Mick Brown's authorised but punchy biography will not give them many answers. His subject's success is proof that business is no science. Mr Branson, who is still only 37, seems to have had a wonderful time building up the Virgin business as an innocent lark.

Not for one minute has his odd mixture of shyness and abundant confidence stopped him from getting his own way. City

finance men are left bemused at his multi-coloured sweaters and his demands for millions in overdrafts. Mr Branson has been known to hold board meetings in the bathroom of his houseboat, conducting from the bath. Mr Manfred Kets de Vries, a business professor and practising psychoanalyst, puts him firmly among "dramatic" business leaders—audacious people driven by a need for activity, excitement and unconventional risks. Mr Carlo de Benedetti, president of Olivetti, is another of these. Mr Branson is of the sub-species that wears Mickey Mouse ears at work.

All his life Mr Branson seems to have been scheming to make money. At seven, he won a pound for learning to swim from an aunt who smoked cigars and parachuted from aeroplanes for fun. He enjoyed upsetting convention; at 11, he saved himself from expulsion from a dismal Sussex crammer by feigning suicide. He had been caught with his pyjamas down, having shinned down a drainpipe after "feelies" with the headmaster's daughter.

He went on to Stowe, where he told an astonished headmaster he would stay on if a telephone were put in his study. Mr Branson wanted one to sell advertising for his student magazine. He left Stowe with an A-level in ancient history and a prediction from the headmaster that "you will either go to prison, or become a millionaire."

Later, Mr Branson got caught trying to evade purchase tax. On another occasion, exasperated beyond endurance, Courts refused to extend Virgin's overdraft and

threatened to bounce its cheques if they exceeded a £200,000 limit by as much as £25. More than 20 years on, however, Mr Branson has made £100m out of cheap records and transatlantic flights. His latest venture is to develop a £50m leisure and shopping complex in the heart of Milton Keynes.

When Virgin went public in 1986, small investors fought for shares. The City rebuffed the offer. In doing so, it was expressing its own peculiar confidence in Mr Branson's success. Virgin was Mr Branson. Would it remain so when he was not at the centre but off running his private airline.



Next stop, Milton Keynes

ing balloons and ridding Britain of AIDS?

In the end, Virgin triumphed. After one year's trading, profits were £31m on sales of £250m. Profits have fallen since then, but the City's cautious men are getting the orderliness they like. The bankers made Virgin write a strategy, and its managing director has an MBA. Mr Branson himself, as this book shows, could not care less about things like that.

Ingmar Bergman

Death and taxes

THE MAGIC LANTERN. By Ingmar Bergman. Hamish Hamilton; 312 pages; £14.95. Viking; \$19.95

SIX years ago, at the age of 64, Ingmar Bergman announced that "Fanny and Alexander", his 42nd film, would be his last. The greatest living Swedish film maker was then at the peak of his powers. But he read the signs of approaching age:

solving problems became more sluggish, staging caused greater worries... I had seen far too many of my colleagues falling in the ring like tired clowns and dragged out of the lights by kindly or contemptuous circus hands. I shall take my hat while I can still reach the hatrack and walk off by myself.

Mr Bergman's has been a protean talent, embracing celebrated theatrical productions as well as film making. How, over a long career, did he maintain such high standards? Sometimes, in truth, he did not. He is his own sternest critic over failures such as "The Serpent's Egg" and "Face to Face". But the high spots (which include "The Seventh Seal", "Wild Strawberries" and "Persona") were many and durable.

On set, Mr Bergman had no time for improvisation or temperament. Editing was something that was done in the mind and on the wing, not in the cutting room afterwards. Never too proud to borrow when his stock was low (he did so to finance "Cries and Whispers"), he was aware that he was indebted to commerce for the privilege of practising his craft. "I have always appreciated the honest brutality of the international film world," he says. "One need never doubt one's worth in the market."

Mr Bergman was brought up in a parsonage that sounds like purgatory. He was obliged not only to confess his sins to his father but to stipulate the number of whacks he should receive. Young Ingmar often found himself locked in a closet, supposedly with a creature that fed on children's toes, or forced to spend the night in the mortuary among the flatulent corpses. He suffers to this day from unruly bowels.

As a child, he had a "tormented and joyless" relationship with God. He claims to

have lost his faith irrevocably 20 years ago when six hours of his life disappeared without recollection during an operation. It convinced him, he says, that "When you die you are extinguished... A god does not necessarily dwell among our increasingly capricious atoms." God never features in Mr Bergman's work after that; some would say for the better.

Mr Bergman regrets the end of his collaboration with Sven Nykvist, the cameraman who shared his fascination with light and with whom he created some of his finest works. But Victor Sjöström, the 80-year-old film maker pressed back into service for "Wild Strawberries", emerges as an incorrigible ham, with a great regard for his co-stars' ample bosoms and an unwavering commitment to a stiff whisky at 4.30 in the afternoon.

Some issues remain murky: in particular, Mr Bergman's arrest for alleged tax-dodging, a traumatic experience that drove him temporarily into exile in West Germany. It



Focused on Purgatory

would be interesting to know more, too, about the Bergman family's temporary embrace of Nazism. It sits uncomfortably with the author's assertion that he has always been a Social Democrat.

The probable overloading of the American mind

Chic, Kantian and 40

FOR month after month, the American non-fiction bestseller lists have been dominated by "difficult" books. Alan Bloom's "The Closing of the American Mind", a philosopher's treatise on the decline of the national intellect; James Gleick's "Chaos: Making a New Science", described by one reviewer as "making the music of chaos soar"; Paul Kennedy's "The Rise and Fall of the Great Powers", a dense 700-page ramble through the mistakes of western history; and now Professor Stephen Hawking's "A Brief History of Time" ("a feast for cosmological gourmets which others may have trouble digesting"). Books on how to make money and how to lose weight are now decently separated by slabs of hard intellectual graft.

When Mr Bloom first appeared in the charts, commentators refused to give his readership much credit. Word had got round that one chapter compared rock to masturbation; it was for this, undoubtedly, that people were reading him, and not for the chapter headed "From Socrates' 'Apology' to Heidegger's 'Rektoratsrede' ". Mr Kennedy is said to be being read only for his last chapter where, shaking off the dust of the Holy Roman Empire, he starts to discuss the morbid symptoms of the United States. But the two scientific books, neither of them so skimmable or extractable, suggest to some that a different sort of trend is afoot.

Mr Henry Allen, writing in the *Washington Post* at the beginning of May, claims

to have uncovered something quite new, which he calls "smart chic". Since baby-boomers can go no further in indulging or improving their bodies, they must turn to their minds. Mr Allen has found other signs beyond the non-fiction lists: a best-selling novel, for example, which has a philosopher, Ludwig Wittgenstein, as its main character, and a rock band called "The Jean-Paul Sartre Experience".

"Remember, you read it here first!" shouts Mr Allen; but Mr P.J. O'Rourke stole a march on him in February, with a piece in the *American Spectator* which went much further into the anguish behind the trend. The whole baby-boom generation, wrote Mr O'Rourke, is old, fat and washed up; besides, it knows it has achieved nothing, intellectually or otherwise. "All our mystical enlightenments", sighs Mr O'Rourke, "are now printed in Hallmark greeting cards with pictures of unicorns on them."

If the baby-boomers have not been taken seriously, it is simply because they are not serious; and this can be rectified fairly smartly.

We get those stupid half-glasses and wear them way down on the end of our nose. We read Schopenhauer, Kant, all those guys. We call it the New Seriousness... [we] shoot MTV videos for Handel and Rimsky-Korsakov. Do a feature movie about the life of Euripides with the sound-track in ancient Greek.

Mr O'Rourke pinpoints an important element of the New Seriousness: it may be as



Mensa, mensa, mensam

much self-defence as self-improvement. But defence against what? True historians of the trend trace it back to philosophers at the University of California at Berkeley who, in the mid-1980s, began to attack the notion of "thinking computers". Two men in particular, Dr Hubert Dreyfus and Dr Fernando Flores, turned to the theories of a German philosopher, Martin Heidegger, to find their way through the maze of computerisation and automation ("Being" and "Time", the twin titles of Heidegger's master-work, presumably being two notions among many that computers cannot grasp). Their work may have been the first warning sign that, if minds are to be considered superior to computers, they had better be well stocked and working.

So off to buy "A Brief History of Time". The particular attraction of physics is that, once translated from mathematics into English, it lends itself to supposition and cloudy thinking. Like philosophy, it is relatively easy for the layman to bluff in; chemis-

try or genetics is not. The new trend, if trend it is, is likely to run to earth if faced with too many hard facts, too much hard grammar, or equations. High seriousness, when it is fashion, can be taken only so far.

Theatre in Japan Orbis Tertius

TOKYO

THE third incarnation of London's Globe theatre (burned down in 1613, closed by Cromwell in 1644) has not occurred, after all, on its original site in Southwark on the south bank of the Thames. It has sprung up, in pink concrete, not far from the world's busiest railway station: Shinjuku in Tokyo.

The Bard has a curious standing in Japan. His plays are rarely taught at school; even in translation, only university students seem to read him. Yet the bloody histories and tragedies, in particular, seem to fascinate the Japanese. They appear on television (Lawrence Olivier's "Richard III" was shown on May 13th) and at least one celebrated director, Mr Akira Kurosawa, has based his films on them, modelling his "Throne of Blood" on "Macbeth" and his "Ran" on "King Lear". The Japanese tendency is not faithfully to reconstruct Shakespeare but to remake him in the Japanese image. This is exactly what Mr Arata Isozaki, the Globe's architect, claims to be doing with his theatre.

The Tokyo Globe is an abstract version of what Mr Isozaki thinks the original looked like. He had little to go on. No plans of the original Globe survive; only an aerial view of the second Globe and its surroundings by Wenceslaus Holler, drawn from a convenient church tower, and a sketch of the inside of a theatre contemporary with

the Globe. These have given Mr Isozaki his basic dimensions. The Globe's interior is modern and precise, executed in grey and dominated by the stage, which extends forward to the centre of the 12-sided auditorium. The prominence of the stage and the geometry of the three galleries, which are set directly on top of each other rather than receding, seem authentic enough. The greatest loss to authenticity is probably the lack of crowding; contemporary notions of comfort and safety mean that the theatre can hold only 650, all decently scented and well mannered.

The Globe's opening season runs from April to July. The English Shakespeare Company, fresh from the Old Vic, christened the theatre last month with "The Wars of The Roses", a series of plays covering English history from the reign of Richard II to the death of Richard III. This is what the Japanese are meant to like, after all; but the result was curiously flat. The audience intently followed the action in translation, while the actors, perhaps depressed by this, seemed inclined to play for laughs.

Matters may improve when the theatre starts playing in Japanese, as it will later this summer, though not before audiences have sat through the National Theatre's "Tempest", a few of the Royal Shakespeare Company's workshops and "Hamlet" in Swedish (in Ingmar Bergman's production). From August onwards, most of the productions will be in Japanese and will not be confined to Shakespeare.

At least one other Japanese Globe is under consideration. Whether or not it is built will depend on how voraciously Shakespeare is consumed. It may be worth noting that Mr Kurosawa's films have not been nearly as successful in Japan as they have been overseas. Even when the Japanese remake Shakespeare to suit themselves, he remains less than a craze.

Lilac blooms

FOR the past three years a wooden *dacha* in the writers' encampment of Peredelkino, in the forest outside Moscow, has charted the progress of literary *glasnost* in Russia. The cottage was the summer home of Boris Pasternak, who wrote much of his poetry in a cramped study upstairs. Downstairs in the parlour was a Bechstein piano, on which Sviatoslav Richter played at Pasternak's funeral in 1960. Until three years ago, Pasternak's heirs continued to live in the house; but it was in the gift of the Writers' Union, and in 1985 the Pasternaks were evicted. The neighbours protested, saying they wanted the *dacha* to be kept as a

shrine to Pasternak. The Writers' Union refused, and stripped the house bare; but nobody moved in. A notice appeared on the gate: "Here there is to be a museum", to which somebody added, in pencil, "of Pasternak."

Many years ago another poet, Yevgeny Yevtushenko, first met Pasternak at the *dacha*. There they read their poetry to each other. Mr Yevtushenko remembers that Pasternak's "whole appearance had an amazing, sparkling freshness, like a newly cut bunch of lilac with garden dew still on its leaves." With other writers, he has taken up Pasternak's cause, arguing that his novel "Dr Zhivago"—banned in the Soviet Union since it was written for its portrayal of the beastliness and corruption of the revolution—should be pub-

lished; that Pasternak should be posthumously readmitted to membership of the Writers' Union; and that the *dacha* should become a Pasternak museum. All these things have now come to pass. "Dr Zhivago" appeared this spring, in instalments, in the journal *Novy Mir*; and on May 12th official consent was given to the shrine at the *dacha*. Of late, the gate has been left open.

The study walls were once hung with illustrations drawn by Pasternak's father for Tolstoy's "Resurrection". Pasternak used to show these to visitors and remark that although they had been banned by the Tsarist censors, they had eventually been published. "In the end", he said, "Zhivago" will be published too, here in Russia." And so it is.

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Initial inquiries may be made to Mr J. Hoogland for the post(s) sub A, and to Mr J. Vogelaar for the post(s) sub B. Telephone (31) 10-4081804.

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Mr A. A. Ruitenberg
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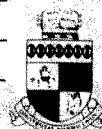
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Shareholders are hereby invited to attend:

1. The Ordinary General Meeting which will be held on Monday 6 June 1988 at 10am to transact the following business:

AGENDA

1. Report of the Board of Directors and report of the External Auditors on the operations of the financial year 1987.
2. Approval of the Annual Accounts for the financial year 1987—Appropriation of profits and declaration of dividend.
3. Release to be given to the Directors and Auditors for their acts during the financial year.

4. Board of Directors:

a) Statutory appointments:

- Appointment of Solvac as Director to complete the term of office of Mr Paul Washer, who has tendered his resignation.
- Appointment of three Directors to replace Messrs Claude Loutrel, Jean-Jacques Van de Berg and André Ganshof van der Meersch, who have tendered their resignations and being eligible have offered themselves for re-election for a new term of office of six years.

b) Change in the remunerations of the Directors.

5. External Auditors:

- a)—Reduction in the number of External Auditors from two to one, following the retirement at the age limit of Mr Pierre van Mook.

—Change in the remuneration of the External Auditor.

b)—Appointment of a substitute External Auditor.

6. Other business.

2. The Extraordinary General Meeting which will be held on Monday 6 June 1988, following the close of the Ordinary General Meeting, to transact the following business:

AGENDA

- I Special report of the Board of Directors on the following items on the agenda.
- II Increase of the share capital from 12,000m. BF to 30,000m. BF without issue of new shares, by incorporation of the amounts booked under the headings "Issue Premiums", "Revaluation surplus", "Tax-exempt reserves" and "Available reserves".
- III Approval of an authorised share capital comprising four tranches:
 - the first, to allow workers, employees, middle management and executives of Solvay & Cie and of the companies belonging to the Solvay Group to partake in the capital, on the occasion of the 125th anniversary of Solvay & Cie;

The special report, mentioned in item I of the agenda of the Extraordinary General Meeting, is available at the Registered Office. Thus, the people proving that they are holders of bearer shares will be entitled to take knowledge of the report and ask for a copy of it.

The Board of directors respectfully reminds the shareholders that, in order to attend these meetings, if their shares are bearer shares, they will have to lodge these shares temporarily and have them blocked at the Registered Office of the company or at one of the establishments listed below, by Tuesday 31 May 1988 at the latest:

—In Belgium: Générale de Banque
Banque Bruxelles Lambert
Kredietbank
Crédit Général

—In Germany: Deutsche Bank

—In France: Lazard Frères & Cie
Banque de la Mutuelle Industrielle

The foreign banks named above have the faculty, in their respective countries, to associate with other establishments where Solvay shares can also be validly lodged. The list of these establishments will be published in due time in each country.

On the other hand, if their shares are registered, the holders must notify the company in writing, by Tuesday 31 May 1988 at the latest, of their intention to attend this meeting, indicating the number of shares they hold or represent.

Similarly, in conformity with article 38 of the Articles of Association, proxies must reach the Registered Office by Tuesday 31 May 1988 at the latest.

Debenture holders wishing to attend this meeting are asked to comply with the same formalities as those imposed on shareholders (Article 37 of the Articles of Association).

Finally, in conformity with Article 78 of the Belgian company law, every shareholder is entitled, on production of his share, to obtain free of charge a copy of the annual accounts, of the report from the Board of Directors, and of the reports from the External Auditors.

The Board of Directors

—the second, to pay for contributions in kind or possible mixed contributions;

—the third, to pay for contributions in cash, possibly under the form of convertible loans or of loans with warrants;

—the fourth, to increase the share capital by capitalisation of reserves and, on the occasion of the 125th anniversary of Solvay & Cie, to issue correlatively free shares in the proportion of one new share for twenty old shares.

Approval, in consequence, of a new statutory provision (article 10bis) authorising the Board of Directors to decide, if necessary notwithstanding the pre-emption rights, on such share capital increases.

IV Other statutory modifications:

- 2.1 Article 5: Modification of the amount of the share capital taking into account the increase to be decided on under item II of the agenda.

- 2.2 Article 6: Modification of the text to take account, in particular, of the fact that the old C shares are now fully paid up. Introduction of a clarification in the definition of the notion "prorata liberationis".

- 2.3 Article 7c: Introduction, if need be, of a clarification in the definition of "transfers of transmissions".

2.4 Article 9b:

(2nd and 4th paragraphs):

Modification of the period of time, to increase it from thirty to sixty days.

(5th paragraph):

Modification of the price formula.

Article 9c:

(2nd paragraph):

Modification of the period of time, to increase it from thirty to sixty days.

- 2.5 Article 41: Introduction of a second paragraph anticipating the removal or possible modification by the legislator of article 76 of the Belgian company law.

- 2.6 Article 45: Introduction of a new first sentence relating to the accounting year.

- 2.7 Article 53: Removal of this transitional article which has become null and void.

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1

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% change at annual rate

	industrial production		GNP/GDP		retail sales [volume]		unemployment % rate	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year	latest	year ago
Australia	-10.8**	+1.0** Jan	+6.1	+4.6 Q4	-0.5	+1.9 Q4	7.9 Apr	8.3
Belgium	+1.7	+0.7 Dec	na	na	+3.5	-0.6 Dec ‡	10.8 Apr*	11.7
Canada	+3.4	+5.7 Feb	+6.3	+5.7 Q4	+1.9	+5.1 Feb	7.7 Apr	9.3
France	+3.9	+2.9 Mar	+1.6	+2.5 Q4	+1.5	-1.1 Jan	10.3 Mar	10.8
W. Germany	+2.6	+2.3 Mar	+2.9	+2.3 Q4	+5.2	+7.0 Mar	8.9 Apr	8.9
Holland	-10.7	-5.5 Mar	+10.8	+1.6 Q4	+7.9	+4.9 Dec ‡	14.0 Apr	14.1
Italy	+3.3	+2.9 Feb	+0.8	+2.8 Q4	+3.0	+4.9 Oct ‡	15.6 Apr*	13.7
Japan	+14.4	+11.3 Mar	+7.0	+5.3 Q4	+11.9	+9.4 Feb	2.6 Mar	2.9
Spain	-3.4	+4.0 Feb	na	na	+15.5	+14.0 Q1 ‡	20.0 Apr	20.2
Sweden	-11.9	-1.9 Mar	+3.7	+2.4 Q4	-3.5	+4.5 Feb	1.6 Apr*	1.9
Switzerland	+24.1	+5.6 Q4	+2.1	+2.7 Q4	+3.9	-0.6 Dec ‡	0.8 Apr*	0.8
UK	-3.3	+1.6 Mar	+1.0	+4.6 Q1	+4.7	+4.5 Apr	8.8 Apr	10.8
USA	+3.2	+6.4 Apr	+2.3	+3.5 Q1	+6.6	+1.2 Mar	5.4 Apr	6.2

† Value index deflated by CPI. ** New series.

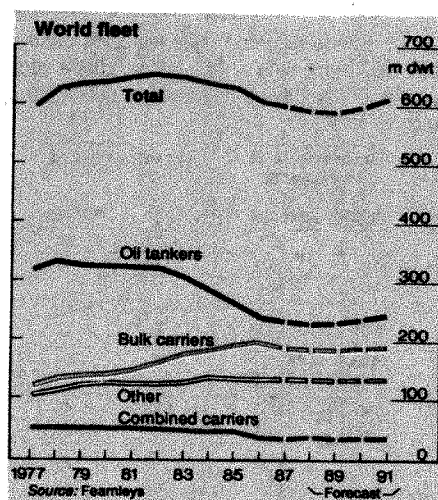
PRICES AND WAGES The 12-month rate of consumer-price inflation in both America and Britain was 3.9% in April. France did better at 2.5%, while Canada's inflation rate was 4.0% in the same month. Australia's wholesale prices rose 7.3% in the year to February; Belgium's fell 0.5%. British wages increased 8.5% in the 12 months to March—a real pay rise of 4.8%. Italian workers saw their pay climb 7.5% in the year to February—a real increase of 2.5%.

% change at annual rate

	consumer prices*		wholesale prices*		wages/earnings†	
	3 mths†	1 year	3 mths†	1 year	3 mths†	1 year
Australia	+7.2	+7.1 Nov	+8.8	+7.3 Feb	+9.8	+5.8 Nov*
Belgium	+1.7	+1.0 Apr	-1.2	-0.5 Feb	+15.4	+2.8 Q4*
Canada	+3.9	+4.0 Apr	+3.0	+4.6 Mar	+6.7	+4.1 Feb*
France	+2.5	+2.5 Apr	+4.3	+3.1 Q4	+3.3	+3.5 Jan*
W. Germany	+2.4	+1.1 Apr	+1.3	+0.6 Mar	+1.6	+3.0 Mar
Holland	-0.5	+0.7 Apr	-1.0	-0.1 Feb	+0.7	+0.5 Mar
Italy	+5.0	+5.0 Apr	+4.5	+4.3 Mar	+6.2	+7.5 Feb*
Japan	-2.1	+0.7 Mar	-3.0	-0.7 Apr	+0.6	+2.2 Mar
Spain	+5.8	+4.6 Apr	+3.3	+2.8 Mar	+8.6	+9.2 Mar
Sweden	+6.6	+6.1 Apr	+7.0	+4.8 Mar	+9.4	+6.2 Jan*
Switzerland	+3.5	+1.9 Apr	+3.9	+2.0 Apr	nil	+2.1 Q4*
UK	+4.7	+3.9 Apr	+5.8	+4.2 Apr	+9.4	+8.5 Mar
USA	+3.6	+3.9 Apr	+1.4	+1.7 Apr	+2.6	+2.9 Apr

* Monthly wage rates in manufacturing except Australia, weekly earnings; Japan, and Switzerland, monthly earnings; Belgium, Canada, Sweden and USA, hourly earnings; UK, monthly earnings for all employees.

SHIPPING The 1980s have not been kind to shipowners. Lower oil consumption (the world now guzzles 7% less than it did in 1979) and the growing use of oil pipelines have hit demand for tankers—their total tonnage has fallen 30% since the late 1970s. The tonnage of bulk carriers on the seas is also stagnant; only grain-carrying fleets prospered last year. Although the world's fleet is now at its lowest level since 1977, Fearnleys, a firm of shipping analysts, is optimistic that it may soon head out of the doldrums. Oil consumption is picking up again: by 1991 Fearnleys expects that oil-tanker tonnage will have increased by 4% from 1987's 233m deadweight tonnes (dwt). It thinks the total tonnage of the world fleet will recover to more than 600m dwt by 1991—its highest level since 1986.



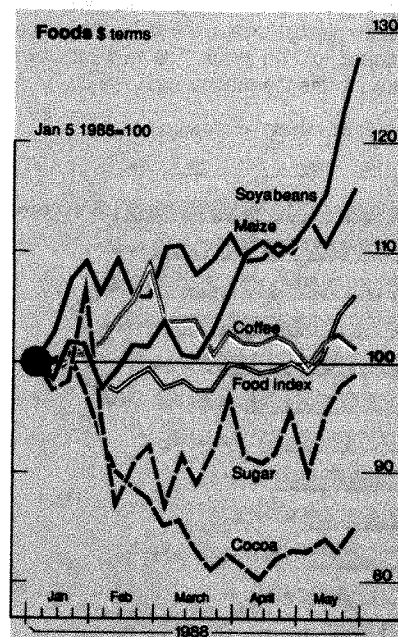
Footnotes applicable to all tables. All figures seasonally adjusted except * not seas. adj. † Average of latest 3 months compared with avg. of previous 3 mos, at annual rate. na not available.

The Economist

COMMODITY PRICE INDEX

The Economist food index, flat for the first four months

of the year, rose 6% during May. Prices of beverages and oils remain depressed, but soyabeans and grains have been enjoying a speculative rally following prolonged dry weather in the prairies of Canada and America. Soyabean futures shot past \$8 a bushel last week—the highest since 1984—but then profit-taking and rain at the weekend damped down prices. Winter wheat, which is nearly ready for harvest, is most vulnerable to the dry weather: wheat prices are at their highest for two years.



1985=100

May 17 May 24† % change on one month one year

Dollar index

All items	158.3	156.8	+9.6	+44.8
Food	110.5	112.3	+6.1	+18.3

Industrials

All	205.9	201.0	+11.6	+65.3
Nfa ‡‡	152.6	156.5	+2.7	+19.1
Metals	243.6	232.4	+16.5	+102.9

Sterling index

All items	108.9	107.6	+10.1	+26.8
Food	76.0	77.1	+6.6	+3.6

Industrials

All	141.6	137.9	+12.1	+44.8
Nfa ‡‡	105.0	107.4	+3.1	+4.4
Metals	167.6	159.5	+16.9	+77.8

SDR index

All items	116.6	115.6	+10.2	+36.3
Food	81.4	82.8	+6.7	+11.4

Industrials

All	151.6	148.2	+12.2	+55.7
Nfa ‡‡	112.4	115.5	+3.2	+12.2
Metals	179.4	171.5	+17.1	+91.1

Gold

\$ per oz	454.25	458.50	+2.4	+1.2
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Crude oil North Sea Brent

\$ per barrel	16.78	16.40	-4.7	nil
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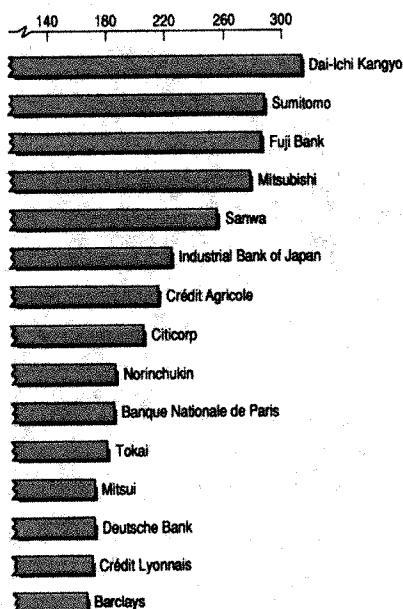
‡ provisional ‡‡ Non-food agriculturals

ECONOMIC AND FINANCIAL INDICATORS

2

BANKING Seven of the world's ten biggest banks (as measured by the size of their total assets at the end of last year) are Japanese. Back in 1980 only one, Dai-ichi Kangyo, was in the top ten. Now it is the world's largest bank, with assets of over \$300 billion; Sumitomo has overtaken Fuji Bank to take the number two slot. During the past couple of years the assets of Japanese banks have increased sharply in dollar terms because of the strength of the yen. There is now only one American bank in the top ten: Citicorp, which used to be the world's biggest in the early 1980s, is now in eighth place. Bank of America, which was the world's biggest bank in the 1970s, has since dropped to 27th place. The two European banks in the top ten are both French.

World's top 15 banks end-1987 assets, \$bn



Sources: Salomon Brothers; Bankers Association of Japan

WORLD BOURSES Wall Street, still worried about inflation, fell 1.2% in the week. Investors were also wary in Milan, which fell 2.2%, and in Tokyo, which fell 1.8%. Higher gold prices helped Johannesburg to soar 4.3%, and Sydney to rise 2.2%.

	May 24	1988		one week	one year	record high	% Change on	
		high	low				31/12/87	in \$ terms
Australia	1470.0	1470.0	1170.7	+ 2.2	- 18.5	-36.3	+12.1	+21.7
Belgium	4640.1	5043.1	3608.4	- 1.1	+ 2.8	-14.3	+27.0	+17.4†
Canada	3183.5	3402.4	2977.9	- 1.2	- 13.4	-22.6	+ 0.7	+ 5.5
France	315.2	315.2	251.3	+ 2.1	- 26.7	-31.5	+12.3	+ 4.4
W. Germany	1325.7	1457.5	1207.9	- 1.5	- 23.6	-41.8	+ 2.0	- 5.7
Holland	239.4	280.3	205.7	- 1.6	- 16.3	-28.3	+14.7	+ 6.6
Hongkong	2516.2	2684.1	2223.0	- 0.7	- 14.3	-36.3	+ 9.3	+ 8.5
Italy	470.0	545.1	423.9	- 2.2	- 32.1	-48.2	- 3.7	-11.2
Japan	27312.7	27820.0	21217.0	- 1.8	+ 11.1	- 1.8	+26.7	+23.7
Singapore	957.0	976.1	833.6	- 1.4	- 20.7	-36.4	+16.2	+15.2
South Africa	1577.0	1577.0	1387.0	+ 4.3	- 17.8	-30.4	+ 9.3	+16.2†
Spain	270.9	281.1	225.5	- 0.4	+ 18.5	-16.7	+19.2	+14.3
Sweden	2918.0	2918.0	2148.5	+ 2.2	+ 10.2	-10.7	+34.5	+31.7
Switzerland	500.3	539.5	466.6	- 1.3	- 13.8	-31.4	+ 5.5	- 5.4
UK**	1782.9	1855.5	1694.5	- 0.4	- 17.2	-27.0	+ 4.1	+ 3.5
USA	1962.5	2110.1	1879.1	- 1.2	- 14.6	-27.9	+ 1.2	+ 1.2

**New series (FT-SE 100)

†Converted at financial rate

MONEY AND INTEREST RATES In February the 12-month growth of France's money supply slowed to 1.7% on the narrow M1 measure and 8.1% on broader M3. Italy's also slowed, to 7.4% in M1 and 7.2% in M2. The growth in Sweden's broad money quickened to 6.5% in March.

	Money supply		Interest rates % p.a. (Tuesday, except bonds which are previous Friday)							
	% rise on year ago		Money market		Commercial banks		Bond yields		Eurocurrency	
	Narrow [M1]	Broad†	Overnight	3 months	Prime lending	Deposits 3 months	Gov't long-term	Corporate	Deposits 3 months	Bonds
Australia	+19.6	+13.9	Mar	12.00	12.75	13.75	12.50	12.33	13.33	12.38
Belgium	+ 4.7	+10.2	Q4	6.00	6.10	8.50	5.80	7.84	8.08	6.19
Canada	+ 1.8	+ 5.6	Apr	8.90	9.30	10.25	7.50	10.34	10.54	9.00
France	+ 1.7	+ 8.1	Feb	7.50	7.50	9.45	7.81	9.23	9.84	7.82
W. Germany	+10.5	+ 6.1	Mar	3.20	3.60	5.50	3.28	6.35	6.05	3.50
Holland	+ 7.2	+ 4.8	Feb	3.88	4.13	5.75	3.50	6.19	6.66	4.00
Italy	+ 7.4	+ 7.2	Feb	10.25	11.25	12.63	na	10.51	10.67	10.38
Japan	+ 9.5	+11.8	Mar	3.25	3.81	3.38	1.76	4.69	4.30	4.19
Spain	+10.3	+14.0	Dec	10.85	11.01	14.50	7.50	12.24	13.70	9.75
Sweden	na	+ 6.5	Mar	9.65	10.90	12.00	10.48	11.35	12.15	10.50
Switzerland	+18.1	+11.6	Feb	2.50	2.58	5.25	1.75	5.07	4.36	2.50
UK	+20.8	+20.9	Mar	7.88	7.66	8.50	7.56	9.40	10.67	7.63
USA	+ 3.4	+ 6.0	Apr	7.00	7.26	9.00	7.29	9.35	9.72	7.50

Other key rates in London 3-mth Treasury Bills 7.2%, 7-day Interbank 7.3, clearing banks' 7-day notice 2.0%. Eurodollar rates (Libor): 3 mths 7.4%, 6 mths 7.7%.

†M2 except Australia, Canada, France, Spain, Switzerland, USA, UK, W. Germany M3, Japan M2 plus CDs. Definitions of interest rates quoted available on request. Sources: Bank of Bilbao, Chase Manhattan, Banque de Commerce (Belgium), Nederlandse Credietbank, Credit Lyonnais, Svenska Handelsbanken, ANZ Bank, Credit Suisse First Boston, Wharton Econometrics. These rates are indicative only and cannot be construed as offers by these banks.

TRADE, EXCHANGE RATES AND RESERVES The dollar's trade-weighted value fell 0.4% during the week; the yen's rose 1.1%, the D-mark's fell 0.2%. France's current account moved into deficit in 1987 to the tune of \$4.6 billion, after a surplus of \$3.0 billion in 1986. Sweden's visible-trade surplus widened slightly to \$3.7 billion in the 12 months to April; its current-account deficit narrowed to \$1.4 billion in the year to March. Spain's visible deficit widened to \$16.5 billion in the 12 months to April.

	trade balance‡ \$bn			current-account balance \$bn latest 12 mths	trade-weighted‡ exchange rate		currency units per \$		currency units			foreign reserves†† \$bn		
	latest month	latest 12 months			latest	year ago	latest	year ago	per £	per SDR	per ecu	Mar	year ago	
Australia	— 0.03	Mar	— 0.1	— 8.5	Mar	58.6	55.8	1.28	1.40	2.39	1.75	1.57	9.3	6.5
Belgium	— 0.32	Dec	— 0.1	+ 2.4	Q2	100.0	100.0	35.5	37.5	66.3	48.6	43.4	9.2	6.1
Canada	+ 0.46	Mar	+ 7.1	— 7.3	Q4	80.8	76.9	1.24	1.34	2.32	1.70	1.52	11.7	6.9
France	+ 0.32	Mar	— 4.8	— 4.6	Q4	71.0	71.6	5.75	6.03	10.7	7.88	7.04	31.2**	31.8
W. Germany	+ 4.90	Feb	+ 64.3	+ 44.5	Feb	147.4	147.1	1.70	1.81	3.18	2.33	2.08	73.0	60.4
Holland	— 0.01	Dec	+ 1.6	+ 3.2	Q4	136.8	135.3	1.91	2.04	3.56	2.62	2.33	15.4	12.2
Italy	— 0.86	Dec	— 8.7	+ 5.9	Q1§	46.1	47.4	1264	1304	2360	1736	1547	29.9	25.1
Japan	+ 8.40	Mar	+ 94.2	+ 83.7	Mar	247.4	222.1	124	143	232	171	152	84.3	58.3
Spain	— 1.50	Apr	— 16.5	+ 0.6	Mar	51.7	48.5	112	127	210	153	138	31.8**	15.5
Sweden	+ 0.58	Apr	+ 3.7	— 1.4	Mar	68.9	68.5	5.91	6.31	11.0	8.10	7.24	8.6	7.9
Switzerland	— 0.40	Feb	— 5.2	+ 7.0	Q4	172.6	174.5	1.42	1.49	2.66	1.94	1.74	24.2	20.8
UK	— 1.57	Mar	— 20.5	— 7.4	Mar	78.4	72.8	0.54	0.61	—	0.74	0.66	41.4	21.5
USA	— 9.75	Mar*	—168.0	—160.7	Q4	93.1	101.3	—	—	1.87	1.37	1.23	32.1	38.7

‡Australia, France, Canada, Japan, and UK imports fob, exports fob. All others cif/fob. †† Bank of England index 1975 = 100. †† Excluding gold. * Not seasonally adjusted. ** February §1987.



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A new air traffic control system for the Federal Aviation Administration will play a key role in helping to meet the growing demand for passenger air travel by making it vastly more efficient. The system is currently under competitive development by a team consisting of Hughes Aircraft Company; Sanders Associates, a unit of Lockheed; and Unisys. The system, called the Advanced Automation System (AAS), promises to be one of the largest real-time computer-controlled systems ever developed. Twenty-three regional air route traffic centers around the nation will receive new equipment, and new computers and automated displays will be installed in nearly 300 airport control towers. AAS will be capable of meeting air traffic control requirements well into the 21st century.

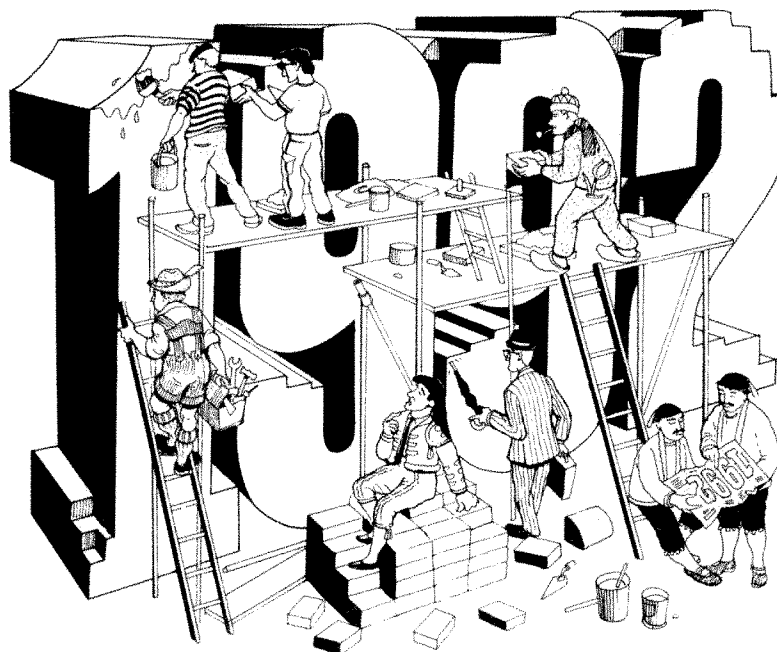
A new printed wiring board (PWB) significantly reduces the manufacturing cost of large backplanes, or motherboards, while improving producibility, performance, and reliability of the computers they help operate. Developed by Hughes for military computer applications, the 18-layer PWB contains 7,500 fewer wires than the one it is designed to replace, and may be the most complex such board ever manufactured. The multilayer design of the new board minimizes the number of machine-wrapped wires, requiring only 2,500 such wires, compared to 10,000 on present PWBs, thus greatly simplifying assembly and inspection.

A single high-power microwave system will distribute 60 television channels in the San Francisco Bay area from one centrally located headend site. The 60-channel AML® high-power array, built by Hughes, will allow United Cable Television Company to interconnect San Francisco's East Bay, South Bay, and Peninsula areas. By using Hughes' AML microwave link, six communities will be served without the expense of hardline transportation trunks or duplicating headend equipment and building facilities. United will also cut operating costs by maintaining only one headend instead of six.

A critical milestone in airborne missile defense technology will soon be subjected to the rigors of flight tests by the U.S. Army Strategic Defense Command. An experimental infrared sensor system, developed by Hughes, will undergo testing aboard a modified Boeing 767 jetliner to detect an intercontinental ballistic missile (ICBM) launched from Vandenberg Air Force Base as it flies through space before reentering the Earth's atmosphere and splashing into the Pacific Ocean. The passive sensor, using an advanced focal plane assembly, could ultimately provide data leading to key components in the Strategic Defense Initiative. Such components would alert defenses in the event an ICBM attack slips through other defensive systems.

A special space-based sensor is able to identify tropical storms earlier than conventional weather satellites. The microwave imaging sensor, designated SSMI, is the first in a series to be flown on the U.S. Air Force Defense Meteorological Satellite program spacecraft. Unlike conventional weather satellites, which see only the tops of clouds, SSMI sees into and through them, giving forecasters a view of the intensity of a storm. The Hughes-built sensor measures wind speeds over oceans, the amount of moisture in the ground and in mountain snow packs, and determines ice coverage. SSMI is also the first space-based sensor that is able to determine where it is raining over land.

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